United States Court of Appeals

for the

District of Columbia Circuit

TRANSCRIPT OF RECORD

JOINT APPENDIX

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19,232

CHESTER A. SNOW,

Appellant,

v.

DISTRICT OF COLUMBIA,

Appellee.

37

No. 19,233

CHESTER A. SNOW RENTS,

Appellant,

v.

DISTRICT OF COLUMBIA,

Appellee.

Appeal From the District of Columbia Tax Court

United States Court of Appeals
for the District of Columbia Circuit

FILED MAY 26 1965

Nathan J. Paulson
CLERK

DOCKET No. 1934

DOCKET NO. 1935

JOINT APPENDIX

DISTRICT OF COLUMBIA TAX COURT

CHESTER A. SNOW Petitioner,	]	
v.	]	Docket No. 1934
DISTRICT OF COLUMBIA Respondent.	]	

Date	Proceedings	Memorandum
May 7	Petition filed — Taxpayer notified — Corporation Counsel and Finance Office served.	Income Tax $20,285.95
Sept 16	Hearing set for Sept 30 — Certificate of service.	
Sept 21	Motion for continuance	
Sept 22	Motion granted — Hearing continued to Oct 20 — Certificate of service.	
Oct 13	Hearing continued to Nov 10.	
Nov 24	Hearing — Henry E. Wixon, Esq., for District. Trial Brief filed.	
Dec 7	Motion for extension of time within which to file brief for respondent — Granted — Certificate of Service.	
Dec 23	Motion for extension of time within which to file brief for respondent.	
Dec 24	Motion granted to Jan 4. Certificate of service.	
1965		
Jan 4	Brief for Respondent — Certificate of service.	
Jan 7	Reply Brief of Petitioner — Certificate of service.	
Jan 15	Supplemental Stipulation.	
Feb 15	Findings of Fact, Opinion, Decision — Certificate of service.	
Mar 2	Amendment to Opinion — Certificate of Service.	

Mar 3 Order for Consolidation of causes — Certificate of service.

Mar 3 Petition for Review — Certificate of service.

Mar 9 Designation of Record — Certificate of service.

[Filed, May 7, 1964]

[Docket No. 1934]

PETITION

The above-named petitioner appeals from an assessment of taxes against him, and avers as follows:

1. Petitioner is an individual with residence at 4426 Cathedral Avenue, N. W., Washington, D. C.

2. The tax in controversy is an individual income tax for the year ended December 31, 1960, in the amount of Seventeen Thousand Two Hundred Sixty-four Dollars Sixty-four Cents ($17,264.64) with interest of Three Thousand Twenty-one Dollars Thirty-one Cents ($3,021.31) for a total of Twenty Thousand Two Hundred Eighty-five Dollars Ninety-five Cents ($20,285.95).

3. The notice of assessment (statement of taxes due) was dated March 13, 1964, as will appear from a copy thereof, hereto attached as Exhibit "A". The tax was paid by petitioner on March 16, 1964. A copy of the notice of deficiency and of the statement of audit changes explaining the deficiency are attached hereto respectively as Exhibit "B" and "C", with the explanation appearing on the reverse of the statement of audit changes as Exhibit "D".

4. The assessment of tax is based upon the following errors:

(a) "Dividend - Lombardy, Inc. $324,318.88" did not constitute income because the fair value of the property received upon the liquidation of Lombardy, Inc. was not in excess of cost of the shares to the holder thereof, to whom the property was distributed on liquidation. Hence to tax as income what is not income was an erroneous interpreta-

tion of the statutes of the District of Columbia and was contrary to and in violation of the Constitution of the United States and the Amendments thereto.

(b) "Rents as reported - $967.32" (loss) and "salary allowance and exemption not taxed - $7,868.91" were erroneously included in income (added back to income) as a result of an erroneous disallowance of depreciation in the return of this taxpayer filed under the Unincorporated Business Franchise Tax Act. Other phases of said disallowance are the subject of a Petition by this taxpayer in a companion docket number in this Court. The items, however, constitute adding back to income (i) a loss otherwise sustained (ii) salary allowance of Two Thousand Eight Hundred Sixty-eight Dollars Ninety-one Cents ($2,868.91) and (iii) an exemption of Five Thousand Dollars ($5,000), all on a recomputation of the Unincorporated Business Franchise Tax Return of this taxpayer. The recomputation of tax of the Unincorporated Business Tax Return of this taxpayer should not have been made. The recomputation resulted from the erroneous refusal of the Government of the District of Columbia to permit deduction of depreciation at a four per cent (4%) rate upon the cost of a building acquired by the taxpayer. The Government of the District of Columbia erroneously applied the four per cent (4%) rate to the "net book value of assets (to the corporation) received (by petitioner) in liquidation, Ninety-one Thousand Four Hundred Fifteen Dollars Eighty-three Cents ($91,415.83)."

5. The facts upon which the petitioner relies as the basis of this case are as follows:

(a) Petitioner paid the full and fair value for all of the shares of the stock of Lombardy, Inc. under an agreement dated the 17th day of July, 1959, and an amendment thereto dated August 7, 1959. Pursuant to said agreement, on January 1, 1960, a settlement under said contract for the purchase of the stock of Lombardy, Inc. was effected and the corporation immediately thereafter liquidated. This petitioner thus obtained assets for which he paid full and fair value equal to the purchase price. Ac-

cordingly, the taxpayer neither gained nor lost upon the liquidation of Lombardy, Inc. since the value of the assets received was not in excess of cost but equaled exactly what the taxpayer paid.

(b) Having acquired all of the stock of Lombardy, Inc. and, in turn, all of its assets at a fixed cost, this petitioner was entitled to deduct from gross income a reasonable allowance for depreciation reflecting the cost of the assets to the taxpayer. The net book value of the assets received in liquidation as shown by the books of Lombardy, Inc. (distributor) has no relation to the cost of the assets by this taxpayer (distributee). That net book value shown on the books of Lombardy, Inc. reflects only the cost of the assets to a former taxpayer, not petitioner.

WHEREFORE, petitioner prays that this Court may hear of the case and order a refund of Twenty Thousand and Two Hundred Eighty-five Dollars Ninety-five Cents ($20,285.95) with interest to date of refund.

/s/ Chester A. Snow
4426 Cathederal Avenue, N.W.
Washington, D. C.

KING & NORDLINGER

By: /s/ Bernard I. Nordlinger
Attorneys for Petitioner

[Verification dated May 7, 1964]

[Exhibit A]

Paid under protest:

GOVERNMENT OF THE DISTRICT OF COLUMBIA
FINANCE OFFICE • Revenue Division

• INCOME AND FRANCHISE TAX

TYPE TAX: I - Individual Income; D - Declaration Payment; H - Corporation; J - Unincorporated Business; F - Fiduciary; E - Employer Withholding

ACCOUNT NUMBER	REF.	TYPE TAX	TAX YEAR		
[redacted]		I	1960	3/16/64	

NAME AND ADDRESS	TOTAL TAX DOLLARS	CTS.	CREDIT DOLLARS	CTS.	INTEREST TO	PAYMENT DUE DOLLARS	CTS.
Sn[redacted] Chester A., [redacted]thedral Ave., N. W., Washington, D. C.	17,264	[illegible]					
Int.	3,021	[illegible]			3/16/64	20,285	95

Interest on payment due at the rate of ½ of 1% per month or portion thereof must be added if not paid on or before the interest date shown on this bill. Late filing penalty is computed at 5% per month or portion thereof (maximum 25%), except type tax E which is a flat 25%.

Make check payable to D. C. TREASURER. Send check or money order to FINANCE OFFICE, REVENUE DIVISION, Municipal Center, Washington 1, D. C.

FP: 56 (9/60) Your cancelled check is your receipt.

Interest at rate of ½ of 1% per month or portion thereof
from to

TOTAL PAYMENT DUE

PAID UNDER PROTEST

D. C. Treasurer

KEEP THIS COPY

COPY 1A - TAXPAYER'S COPY

[Exhibit B]

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Department of General Administration
Washington 1, D.C.

February 3, 1964

Mr. Chester A. Snow
4426 Cathedral Ave., N.W.
Washington, D. C.

Re: #3466587 (60) (WRE)

Dear Sir:

The examination by this office of your Individual Income Tax return(s) for the year(s) ended December 31, 1960, indicates that the adjustment of your tax liability, as shown in the accompanying Report(s) of D. C. Individual Income Tax Audit Changes, is warranted.

IF YOU AGREE to the adjustment(s), as shown in the report(s), the enclosed form of waiver should be executed and forwarded to this office promptly. Action will then be taken as indicated on line 13 or 14 of the report(s), whichever is applicable.

IF YOU DO NOT AGREE to the adjustment(s), you may file a protest with this office, within thirty (30) days from the date of this letter, stating the grounds for your exceptions. Careful consideration will be given to such protest and, if you so request, an opportunity for a hearing in this office will be granted to you prior to final determination.

Should you fail to file either the enclosed waiver form or a written protest with this office within the thirty (30) day period, final determination of your tax liability will be made in accordance with the enclosed report(s).

Yours very truly,

/s/ Ben A. Barsky
Supervisory Tax Auditor
Income and Franchise Tax Section

[Exhibit C]

Finance Office
Revenue Division

GOVERNMENT OF THE DISTRICT OF COLUMBIA
REPORT OF D. C. INDIVIDUAL INCOME TAX AUDIT CHANGES

Name and Address of Taxpayer(s)	Return Number	Date of Report
Chester A. Snow	3466587	1/28/64
4426 Cathedral Avenue, NW.	Year Ended	Tax Auditor
Washington, DC	12/31/60	W R Edelin

1. Taxable income shown on return or as previously adjusted		$ 58,537.77
2. ADD: Additional income or unallowable deductions:		
Dividend - Lombary Inc. [1] Chester A. Snow Kents as reported	$ 324,318.88 / 467.32	
Salary allowance and exemption not taxed [2]	7869.91	
Rental Income - Nonresidential Properties [3]	10,537.70	
Contribution - Chilean Disaster Fund [4]	1000.00	
Casualty Loss [5]	300.00	345,292.81
3. Total of lines 1 and 2		$ 403,830.58
4. LESS: Decrease in income or additional deductions:	$	
5. Revised taxable income		$ 403,830.58
6. Revised tax liability		$ 19,816.53
7. LESS: Total tax shown on return or as previously adjusted		2,551.89
8. Deficiency in tax		$ 17,264.64
9. ADD: Penalty, if any		
10. Total of lines 8 and 9		$ 17,264.64

Computation of Corrected Balance Due or of Net Overpayment

11. Revised tax liability and penalty, if any (total of lines 6 and 9)		$ 19816.53
12. LESS: Total tax paid A. Tax withheld	$ 279.12	
B. Payments on estimated tax	2000.00	
C. With return	272.77	
D. Sum of items A through C	2551.89	
E. Deduct previous refunds and/or credits		2551.89
13. Balance due (Line 11 less line 12) Upon receipt of signed waiver, a bill will be mailed to you for this amount with interest thereon as provided by Law.		$ 17,264.64
14. Net overpayment (Line 12 less line 11) Upon receipt of signed waiver, a refund will be authorized for this amount		$

See other side for explanation of adjustments EXHIBIT C

LC-7

Form FR-115 (4-61)

[Exhibit D]

1. Earned Surplus at date of Liquidation $343,494.00

Less: Expenses 19,175.12

Dividend $324,318.88

THE WORD "DIVIDEND" AS DEFINED IN TITLE I, SECTION 4(m), DISTRICT OF COLUMBIA [illegible] TAX ACT OF [illegible] THAT TYPE OF [illegible] AS "LIQUIDATING DIVIDEND," [illegible] THE TAXABILITY THEREOF IS PROVIDED IN TITLE III, SECTION 2 OF THE ACT.

2. See revised computation on Unincorporated Business Franchise Tax - our file 1112 D

3. Profit as reported $7194.00

Plus unallowable Insurance 931.20

" " Depreciation 2712.50

Revised Profit $10837.70

4. Contributions, to be an allowable deduction, must be to organization whose activities are carried on to a substantial extent within the District. Mere solicitation of funds does not constitute activity.

5. Casualty Loss disallowed as we were advised by your accountant that you had held the property for more than two years.

[1] TAX COURT FOR THE DISTRICT OF COLUMBIA

November 24, 1964

BEFORE:

THE HONORABLE JO V. MORGAN, Judge.

* * *

[4] PROCEEDINGS

* * *

[18] CHESTER A. SNOW

was called as a witness, and having been first duly sworn, was examined and testified as follows:

THE COURT: Give your full name and residence to the reporter.

THE WITNESS: Chester A. Snow, 4426 Cathedral Avenue, Northwest, Washington, D. C.

DIRECT EXAMINATION

BY MR. NORDLINGER:

* * *

[19] Q. Mr. Snow, did there come a time when you became interested in purchasing the Lombardy Apartments on Eye Street? A. That is correct.

Q. Did someone bring that building to your attention? A. That was brought to my attention by my general counsel and business manager, Colonel Stacy Reed.

Q. Spelled S-t-a-c-y R-e-e-d? A. Correct.

Q. Did you reach a decision to purchase the apartment house? A. We did, in the summer of 1959.

Q. Were you able to purchase the apartment house --

THE COURT: Why don't you let him testify?

MR. NORDLINGER: Sir?

THE COURT: You are asking these leading questions. [20] Of course they are a little histroical but I think it will be more convincing if he testifies.

MR. NORDLINGER: Very good, sir.

BY MR. NORDLINGER:

Q. Did you sign a contract for the purchase of the apartment house directly or for the shares of stock of the corporation?

MR. WIXON: I object. There has been no testimony of anything except a conclusion on the part of Mr. Snow as to his desires.

THE COURT: I think the contract speaks for itself. Ask him what contract, if any, did he enter into and then you can introduce it.

MR. NORDLINGER: That has already been received by the Court.

THE COURT: Why state what it is? Can't I read it?

MR. NORDLINGER: Yes, sir. I wanted him to tell your Honor how he happened to sign the contract in that form.

BY MR. NORDLINGER:

Q. Will you tell the Court, please, Mr. Snow --

THE COURT: Why don't you refer to the contract and its terms and ask why he did so and so.

BY MR. NORDLINGER:

Q. Referring to the contract, Mr. Snow, how did it happen that you signed it in that form? Tell the Court [21] about it.

MR. WIXON: I object. It is immaterial.

THE COURT: In what respect? I mean there ought to be some reference to the terms of the contract to see if I can understand his testimony. You want the whole contract, why he entered the contract?

MR. NORDLINGER: Yes, sir.

THE COURT: I can answer that myself. He wanted to buy the building.

MR. NORDLINGER: That is exactly what we are trying to prove.

THE COURT: Well, he wanted to buy the building. He wanted to get the building.

MR. NORDLINGER: If this is stipulated, then we do not need further testimony from the witness.

THE COURT: He wanted to get the building, but the point is how

did he do it? Did he get it by going to buy the building or did he use some other method?

MR. NORDLINGER: Very well, sir. All of those facts are now in the stipulation and as your Honor will observe the contract itself calls for the purchase of the stock as distinguished from the land and building and I wanted to ask him how it happened that he entered into the contract to purchase the stock.

THE COURT: What difference does it make? He did [22] enter into the contract to buy the stock, didn't he?

MR. NORDLINGER: Yes.

THE COURT: And he bought the stock?

MR. NORDLINGER: Yes.

THE COURT: What difference does it make as to his reasoning?

MR. NORDLINGER: There could be some difference, I take it, depending upon his intention.

THE COURT: The intention was to buy the stock and I suppose if he got the stock, he could finally take and buy the building. I think that is plain.

MR. NORDLINGER: Yes, sir, that is what I am trying to prove. If it is plain to your Honor he had the intention of purchasing the land and building and not the stock --

THE COURT: I think it irresistible. Here is a man that buys the stock and then turns around and dissolves the corporation and takes the assets, or whatever he takes, and that is what he intended to do, wasn't it?

MR. NORDLINGER: Yes, sir, that is what I wanted to ask him and if your Honor thinks it unnecessary, I will not ask him.

THE COURT: All of the steps are set forth in the contract, aren't they?

MR. NORDLINGER: No, sir.

[23] THE COURT: I mean not in the contract, but in the stipulation?

MR. NORDLINGER: Yes, sir.

THE COURT: He bought the stock and then the corporation was dissolved and they distributed the assets. I don't know what sort of assets they distributed, but he finally wound up with the building, didn't he?

MR. NORDLINGER: Yes, sir.

THE COURT: And he intended to do that, didn't he?

MR. NORDLINGER: No, sir, I think he intended to buy the land and building.

THE COURT: But he intended to buy the stock first, didn't he?

I mean, you don't do things without intending to.

MR. NORDLINGER: He never did buy the stock, although the sale of the stock appears on the face of this contract. This settlement was made at the title company and all done at once.

THE COURT: That is all set forth in the stipulation, isn't it?

MR. NORDLINGER: Yes, sir.

THE COURT: You can make any argument you want that he bought the stock.

MR. NORDLINGER: We asked the District of Columbia to stipulate that the sole purpose of petitioner in entering [24] into the contract for the purchase of the shares of stock was for the purpose of acquiring the land and building. The District would not so stipulate. Accordingly I called the witness to prove that is what he intended to do.

THE COURT: I think if the facts as you recite are so, I don't think there is any dispute about it. What he wanted to do was get the building. What steps he took would make him liable for taxes, that is something else again.

MR. NORDLINGER: Exactly, your Honor.

THE COURT: Just like the Berliners. They intended to get the money, sell the property and get money, and they went through certain steps and would up by owing a whole lot of taxes and that may be the case here. I thinkyou have to hold he intended to do what he did.

MR. NORDLINGER: Yes, sir.

THE COURT: Nobody took him by the scuff of the neck and made him do it, did they?

MR. NORDLINGER: No, sir. I think your Honor's observations are 100 percent correct, and I think if we have such findings from the Court, I need not bore your Honor with further testimony from the witness. Your Honor stated he intended to buy the land and building and in order to do so he had to do certain other things which he intended to do in order to acquire the land and building and that is exactly correct. So I have no further questions.

[25] THE COURT: All right. Mr. Wixon?

MR. WIXON: I have no questions.

MR. NORDLINGER: Thank you. You may step down, Mr. Snow.

(Witness excused)

MR. NORDLINGER: The only other thing that the District of Columbia has refused to stipulate to that we feel we need in our case is the propriety of the method of the allocation of the purchase price of the land and building to the building. The District would not stipulate that the method of allocation of this cost was correct.

THE COURT: I think you better show by the evidence what you did and then argue it.

MR. NORDLINGER: We stipulated to what we did. For instance, the stipulation, if your Honor pleases, and it may be that the District upon further consideration may so stipulate, that this method is correct because there really is not hardly any other way to do it.

THE COURT: If the evidence shows what you did, isn't it open to argument on both sides? You say it is correct and they say it isn't.

MR. NORDLINGER: This is the point. For instance, the stipulation in 1935, Case No. 1935, paragraph 4(a) provides as follows: "The allocation of $149,000-odd dollars to land and $654,000-odd to building was derived from allocating [26] out of the total amount paid for corporation stock $803,000-odd to improve real estate. That amount was then allocated in the proportions of the July 1, 1959 D. C. tax assessment to

land and building. Petitioner thus on an allocated basis recorded in his books that he actually paid on or about January 7, 1960, $654,000-odd for said building constituting the Lombardy Apartments."

THE COURT: What you did was take the same proportion as the tax bills show?

MR. NORDLINGER: Yes, sir. Now the respondent does not concede that the foregoing method was correct.

THE COURT: Well, that is something that rests with the judgment of the Court, isn't it? Maybe some other way is better. You have got what you did. You can't change it and you certainly can argue that it is correct.

I don't think you have to call on either side. I don't think you would stipulate it wasn't correct, would you?

MR. NORDLINGER: No.

THE COURT: Why would you ask the District to stipulate it is correct?

MR. NORDLINGER: We have to have some kind of basis for applying a percentage figure.

THE COURT: You have shown what it is. You did it on the same proportion as the assessing authority divided it.

MR. NORDLINGER: Yes, sir. Since I don't know what my [27] distinguished adversary has in mind, with your Honor's permission I better call the accountant and let him tell us what he did and get an opinion from him.

THE COURT: It is your case.

MR. NORDLINGER: Mr. McKinley, please.

ROBERT P. MC KINLEY

was called as a witness, and having been first duly sworn, was examined and testified as follows:

THE COURT: Give your name and address to the reporter.

THE WITNESS: My name is Robert P. McKinley. I am a public accountant. My address is 729 15th Street, Northwest, Washington, D.C.

DIRECT EXAMINATION

BY MR. NORDLINGER:

Q. What is your residence address? A. 4801 Connecticut Avenue, Northwest.

Q. How long have you been in practice in the District of Columbia? A. Approximately 30 years.

Q. During this period have you had occasion from time to time to reach an accounting conclusion concerning the appropriate method of allocation of the purchase price of land and buildings to the respective items involved in the purchase? [28] A. I have.

Q. How many times would you say you have gone through that process? A. I would estimate at least 100 times.

Q. Did you in this Snow case make such an allocation? A. I did.

Q. Will you state to the Court what you did in allocating that purchase price?

THE COURT: Doesn't the stipulation show?

MR. NORDLINGER: Yes, sir, it does.

BY MR. NORDLINGER:

Q. Mr. McKinley, in your opinion was the method that you employed in the Snow case correct? A. It is my opinion it was.

MR. WIXON: I object.

THE COURT: Well, it is merely an opinion. He is an accountant and I think it is permissible. I am going to overrule, your objection.

[Petitioner's Exhibit 1]

STIPULATION

It is hereby stipulated among the parties to this cause, through their respective counsel of record, that the following facts are true and may be introduced in evidence without formal proof, and shall be considered as having been duly proved according to law for the purposes of this case and no other matter, pending or future:

1. On March 13, 1964, Notice of Assessment of a deficiency in income taxes for the year 1960 in the amount of $17,264.64, with interest thereon in the amount of $3,021.31, was delivered to Chester A. Snow. On March 16, 1964, Mr. Snow paid said tax and interest thereon under protest. A copy of the Notice of Assessment (Statement of Taxes Due) is attached to the Petition heretofore filed herein.

2. Under date of July 17, 1959, Chester A. Snow entered into an Agreement with Arthur R. Guy for the purchase of all of the outstanding shares of the common stock of Lombardy, Inc., a corporation organized under the laws of the State of Delaware. A copy of said Agreement is hereto attached and hereby made a part hereof, with the amendment thereto dated August 7, 1959, respectively marked Exhibits A and B.

3. (a) The outstanding shares of the common stock of said corporation consisted of 100 shares of a par value of $100.00 each.

(b) The original journal entry at date of incorporation in 1935 was:

Building	$350,000.00	
Land	$180,000.00	
First Mortgage		$325,000.00
Reserve for depreciation		$ 48,415.00
Capital Stock		$156,585.00

4. On or about January 7, 1960, settlement as of January 1, 1960, under said contract was held at the Real Estate and Columbia Title Insurance Company, 1422 H Street, N. W., Washington 5, D. C., as Case No. 91333, settlement sheet of which dated said date is hereto attached and hereby made a part hereof marked Exhibit C. At time of settlement for the purchase of said shares of stock, the stock was delivered to Petitioner with Powers of Attorney attached and photostatic copies thereof are hereto attached and hereby made a part hereof marked Exhibits D1 through D6 inclusive. The corporation, Lombardy, Inc., immediately liquidated and a copy of the Certificate of Dissolution is hereto attached and hereby made a part hereof marked Exhibit E. All of its assets were distributed to Petitioner who delivered through said Title Company a

real estate promissory note in accordance with the contract, photostatic copy of which is hereto attached and hereby made a part hereof marked Exhibit F, together with a collateral note, photostatic copy of which is hereto attached and hereby made a part hereof marked Exhibit G. Petitioner delivered and caused to be recorded a certain Deed of Trust, photostatic copy of which is hereto attached and hereby made a part hereof marked Exhibit H, conveying as security for said real estate note the land and premises theretofore acquired by Petitioner on the day of settlement by Deed dated January 7, 1960, copy of which is hereto attached and hereby made a part hereof marked Exhibit I. Said deed conveyed to Petitioner the premises known as the Lombardy Apartments situated at 2019 Eye Street, N. W., Washington, D. C.

5. Upon liquidation of said corporation, Petitioner received from the corporation assets of a fair market value as follows:

Real Estate	$ 775,000.00
U. S. Bonds 61	95,250.00
U. S. Bonds 63.68	82,312.50
Cash	46,208.30
Accrued interest	430.60
Prepaid insurance	1,466.44
Supplies	283.54
Total	$1,000,951.38

6. (a) The amount as shown by said Settlement Sheet (Case No. 91333) was paid by Petitioner in the form of a note for $700,000.00 a deposit of $25,000.00 cash at the time the contract was executed and the remainder in cash to said Title Company. The fair market value of the assets received by Petitioner upon liquidation of said corporation was not in excess of the cost to Petitioner of the stock of said corporation.

(b) Prior to the closing of the purchase of the shares of stock, general counsel for Petitioner, Stacy M. Reed, Esquire, sought legal advice with respect to whether or not income tax might be payable to the District of Columbia. In response to that inquiry, Petitioner, through

his general counsel, was advised as set forth in letter dated December 8, 1959, addressed Stacy M. Reed, Esquire, by King & Nordlinger, Esquires, copy of which is hereto attached and hereby made a part hereof marked Exhibit J.

(c) Respondent reserves the right to object to subparagraph (b) upon grounds of relevancy and materiality.

7. At the time of dissolution of Lombardy, Inc., the assets, liabilities, capital and earned surplus of said corporation were as shown on the balance sheet of the corporation as attached to its 1959 Federal Income Tax Return, a copy of which is hereto attached and hereby made a part hereof marked as Exhibit K, and final District of Columbia Corporation Franchise Return, copy of which is hereto attached and hereby made a part hereof marked Exhibit L. Attached hereto as Exhibits M, N, and O is a copy of the Minutes of a Special Meeting of the Board of Directors of Lombardy, Inc. dated the 7th day of January, 1960, a copy of a "unanimous consent to dissolution of Lombardy, Inc." dated January 7, 1960, and a copy of "resignations" of officers and directors of Lombardy, Inc., dated January 7, 1960.

8. The deficiency in income tax and interest assessed against and paid by Petitioner herein is substantially the result of including in revised taxable income the amount of the accumulated earned surplus of Lombardy, Inc. Said surplus was received by Petitioner upon liquidation and dissolution of said corporation. Said surplus was in the form of the real estate and other assets of said corporation.

IN WITNESS WHEREOF, the parties hereto have caused these presents to be executed by their respective counsel of record.

KING & NORDLINGER

/s/ Henry E. Wixon
Assistant Corporation
Counsel, D. C.

Attorney for Respondent

By: /s/s Bernard I. Nordlinger
Attorneys for Petitioner

[Exhibit A]

AGREEMENT

THIS MEMORANDUM OF AGREEMENT, Made the 17th day of July, 1959, by and between ARTHUR R. GUY, of the City of Philadelphia, State of Pennsylvania, hereinafter referred to as "Seller" and CHESTER A. SNOW, of the City of Washington, District of Columbia, hereinafter referred to as "Purchaser".

WHEREAS, Arthur R. Guy is the owner of the entire Common Stock, (being the entire stock or debentures of any nature issued) of Lombardy, Inc., owner of premises known on Lot 824 Square 78, improved by 2019 Eye Street, N. W., Washington, D. C. and was free and clear of all mortgage or deed of trust indebtedness, and,

WHEREAS, the purchaser is desirous of purchasing the Common Stock of the Seller, and the Seller is agreeable upon the terms hereinafter set forth to sell the same.

NOW, THEREFORE, in consideration of the premises and of the promises of each of the parties hereto to the other and of other valuable considerations, the parties have and do hereby agree and covenent with each other as follows:

The purchase price of said Common Stock shall be Nine Hundred Seventy-five thousand dollars ($975,000) with an adjustment of that amount upward or downward for the difference by which the cash, receivables, prepaid expenses and securities owned by said Lombardy, Inc., less accruble and payables are more or less than Two hundred thousand dollars ($200,000); the value of the receivables and securities shall be determined by the actual market value as of the date of settlement. If the adjustment through the aforesaid formula should cause the cash down payment to exceed thirty per cent (30%) of purchase price of said Common Stock, then such excess shall be deducted from the cash and added to the hereinafter described Collateral note. The purchaser shall pay the real estate agents their brokerage or commission, and the

purchaser does hereby agree that the seller shall be held harmless, and he agrees and does hereby indemnify the seller from any obligation in reference to said brokerage or commission.

A deposit of Twenty-five thousand dollars ($25,000) will be paid to Boss and Phelps, Inc. at the time of the signing of this contract as a deposit for the purchase of the Common Stock aforesaid. The purchaser after the inspection of the Lombardy Apartments is made as hereafter provided, shall then indicate his confirmation of this contract, or if he wishes he may disaffirm it and be entitled to receive his deposit of Twenty-five thousand dollars ($25,000) from Boss and Phelps, Inc. If the contract is affirmed by the purchaser the deposit of Twenty-five thousand dollars ($25,000) shall be deposited with the Columbia Title Insurance Company by Boss and Phelps, Inc. together with a copy of this contract.

Settlement shall be made on or before January 7, 1960. The parties hereto agree that Seller shall have the privilege of an earlier settlement, and in the event he desires an earlier settlement, he shall give written notice thirty (30) days in advance to the Purchaser.

At the time of settlement the purchaser agrees to pay Fifty thousand dollars ($50,000) additional in cash, so that the total cash payments, including the aforesaid deposit, shall be Seventy-five thousand dollars ($75,000), and the purchaser also agrees to pay cash of Two hundred thousand dollars ($200,000) more or less, in accordance with the aforesaid formula. Purchaser will arrange for a straw party to execute a collateral note payable to Arthur R. Guy for the balance of the purchase price remaining after cash payment as herein indicated. Said note shall be based on the Nine hundred seventy-five thousand dollars ($975,000) purchase price as adjusted pursuant to the formula hereinbefore set forth, payable fiften (15) years from the date of its execution with interest at the rate of Five and three-fourths per cent (5-3/4%) per annum, payable quarterly, without the privilege of curtail. The Two hundred thousand dollars ($200,000), more or less shall be added to the cash

payment of Seventy-five thousand dollars ($75,000) provided however that if this total sum exceeds 30% of the purchase price such excess shall be deducted from the above total sum and added to the collateral note. The collateral note shall be secured by a first trust note in favor of the seller recorded against the Lombardy Apartments hereinbefore described, in the full amount of the said collateral note, and said first trust note shall likewise provide that it shall be payable fifteen (15) years after date of its execution, with interest at the rate of five and three-fourths per cent (5-3/4%) per annum, payable quarterly. To further secure the collateral note, the purchaser agrees to place along side of the first trust note, Three hundred thousand dollars ($300,000) in United States Government Bonds. The collateral note together with the first trust note and bonds shall be placed in the National Bank of Washington for collection. The usual provisions contained in the collateral note as set forth in the collateral note attached hereto and made part hereof shall obtain between the parties. The purchaser agrees that he shall not have the right to withdraw any of the collateral or make disposition thereof without the consent of the seller until the collateral note referred to above has been paid and satisfied, provided however, that if there should be any reduction in the collateral note a corresponding amount of the bonds may be withdrawn by the purchaser at the same time. The first trust note and the bonds hypothecated thereunder may not be withdrawn without the consent of the seller, but the National Bank of Washington shall hold the same until paid in full unless default occurs, and in that case the terms of the deed of trust and the collateral note shall be the instruments upon which the seller shall be guided. The seller shall have the privilege of substituting the named depository to another institution satisfactory to the purchaser.

All interest earned by the Government Bonds shall be credited to the purchaser or his nominee and may, of course, be withdrawn as earned.

In the event that default should occur and said default continue for a period of thirty (30) days, the purchaser agrees that such default shall operate as an assignment of the rents to which the Lombardy Apartments, heretofore described owned by the Lombardy, Inc. is entitled. The purchaser further agrees that should such default occur, the seller shall have, if deemed necessary by him, the auxiliary aid of the United States District Court for the District of Columbia to appoint a Receiver and in that eventuality the purchaser consents thereto and will not interpose any opposition or defense in such contingency.

If the purchaser shall fail to make full settlement in accordance with the terms of this agreement after he has confirmed the same, the deposit herein provided for shall be paid to the seller, and the Columbia Title Insurance Company is hereby authorized and directed to pay the same in full to the seller. In the event of the deposit being paid to seller as aforesaid, it shall not operate to prejudice any rights the seller or Boss and Phelps, Inc. may otherwise have. What, if any, brokerage or commission is incurred by reason of this transaction shall be borne and paid by the buyer.

Seller shall have the right to accelerate the maturity note of the first trust note and the collateral note on the Lombardy Apartments, upon giving four months notice of such intention to the purchaser provided the purchaser divests himself of title to the Lombardy Apartments, or in the event of his decease. This provision likewise shall be inserted in the Deed of Trust.

Seller assumes the risk of loss or damage to the Lombardy Apartments by fire or other casualty until settlement of this Agreement is consummated, and further agrees to comply with all notices of violations of Municipal orders or requirements noted or issued by any Department of the District of Columbia, or actions in any Court on account thereof, against or affecting the Lombardy Apartments at the date of the settlement of this Agreement.

All refrigerators, screens, window shades, venetian blinds, awnings,

vacuum cleaners, tools, furniture and fixtures, and all equipment now being used in the operation of the Lombardy Apartments, are included in the purchase price of the stock of the Corporation.

Assessments, if any, against the Lombardy Apartments, made by the District of Columbia for improvements completed prior to the date of settlement of this Agreement; whether assessments have been levied or not, shall be paid by seller or allowance made therefor at the time of settlement of this Agreement.

Seller hereby indemnifies purchaser against any and all claims and/or liabilities of Lombardy, Inc., incurred by the said corporation prior to the date of settlement. Provided, further, that any claims required to be paid by seller, or liabilities required to be satisfied by seller, arising out of the operation of Lombardy, Inc., prior to the date of settlement, including legal fees and all other justifiable costs, if incurred, shall be credited against the balance of principal due on the collateral note.

Purchaser agrees to carry insurance coverage on the Lombardy Apartments in an amount sufficient to qualify under 80% clause.

Seller shall have the right to make annual inspections of the Lombardy Apartments during the life of the first trust.

Seller warrants that Lombardy, Inc. owns a fee simple title, good of record and in fact, to the Lombardy Apartments, 1019 Eye Street, N. W., Washington, D. C. known for taxation purposes as Lot 824 in Square 78; that said apartment building and land are free and clear of encumbrances; that the annual gross rental is approximately Ninety-five thousand dollars ($95,000); and that there are only monthly tenancies in the building.

It is further understood and agreed that:

A. Seller agrees to promptly furnish to purchaser a current rental schedule of the Lombardy Apartments, together with a copy of its 1959 operating statement.

B. Seller will promptly arrange for purchaser, and an Electrical Engineer, a Plumbing Contractor, and a Heating Engineer, all of purchaser's selection and at purchaser's expense, to inspect the Lombardy Apartments, including a reasonable number of its units.

C. If, after the inspection is made, the Electrical Engineer, or the Plumbing Contractor, or the Heating Engineer, makes a report of findings, not satisfactory to the purchaser, said purchaser shall be entitled to cancel this Agreement, and upon such cancellation the Columbia Title Insurance Company is directed to return the deposit to the purchaser.

D. Purchaser agrees to complete said inspections within ten (10) days after arrangements for the inspections have been made by seller; and to confirm or cancel this Agreement within five (5) days thereafter.

E. In the event purchaser exercises this right to cancel this Agreement , and so notfies seller, and Boss and Phelps, Inc., of such intent, the deposit of Twenty-five thousand dollars ($25,000) shall be promptly returned to purchaser by Columbia Title Insurance Company, and seller, purchaser and Boss and Phelps, Inc. shall thereupon be relieved from any and all further liability in this matter, and no liability shall be incurred by either party hereto to the other, nor to Boss and Phelps, Inc.

The parties hereto agree that taxes and commissions and all other proper charges, etc. shall be adjusted as of the date of settlment by the title company selected by the purchaser.

The parties hereto agree that Boss and Phelps, Inc. shall be regarded as a party to this contract for the purpose of asserting its rights, if any such exist, in the course of this transaction.

IN WITNESS WHEREOF, the parties hereto have signed their names and affixed their seals the day and year first hereinbefore written.

/s/ Joseph A. Kofferty

/s/ Arthur R. Guy

/s/ Stacey M. Reed

/s/ Chester A. Snow

Boss and Pehlps, Inc., agrees and consents to the terms of the above Agreement pertinent to it:

BOSS AND PHELPS, INC.

By:
President

[Notarial Certificates, dated July 17, 1959]

Washington, D. C.

$____________ ________________19_____

________________ days after date ___________promise to pay to the order of ARTHUR R. GUY________________________DOLLARS substitute throughout for the word "Bank" as it herein appears "Arthur R. Guy" for value received with interest at % per annum, having deposited with said Bank, as collateral security for the payment of the full sum of principal, interest and costs due on this note, and also as collateral security for all other present or future obligations, of any and all kinds, to the said Bank, against the undersigned, due or not due, the following, to wit:

with full power and authority to said Bank, or its assigns, to sell the whole or any part of said security, or any substitutes therefor, or any additions thereto, at public or private sale at the option of said Bank, or its assigns, on the non-performance of this promise or any part thereof, or the non-payment of any other present or future obligations to said Bank as aforesaid, and without advertisement or notice to the undersigned; and upon such sale the holder hereof may purchase all or any part of said securities discharged from any right of redemption. After deducting all proper costs and expenses, the residue of the proceeds of sale shall be applied to the payment of this note, and of any other present or future obligations to said Bank as aforesaid, and the under-

signed agrees to remain liable for any deficiency then remaining. If said net proceeds exceed the unpaid balance of this note, and any other obligations of the undersigned to said Bank, together with interest and costs, such excess shall be paid to the maker hereof. In case of depreciation in the market value of any security at any time pledged pursuant to the provisions of this note, a payment shall be made on account, or additional security added, as required by said Bank. If such payment is not made or additional security added, this note and any other obligations of the undersigned to said Bank, shall at its option, become due and payable immediately and the collateral pledged herein sold as hereinbefore provided.

And the undersigned further agrees that should any litigation ensue to holder with respect to the collection of the said note of the holding of sale of the said collateral security or any part thereof, the said holder shall be paid such reasonable expenses and counsel fees incurred in connection therewith.

Date ________________ ________________________

This loan is/not made for the purpose of purchasing or carrying stocks registered on a National Securities Exchange in accordance with Reg. "U". ________________________

Address ______________________

____
Officer Borrower

[Exhibit B]

Washington, D. C.
August 7, 1959

MEMORANDUM TO: Mr. Arthur R. Guy,
1530 Chestnut Street,
Philadelphia 2, Pennsylvania

This memorandum refers to our Agreement dated the 17th day of July, 1959, relative to my purchase of the entire stock of The Lombardy, Inc.

Pursuant to the provisions in Paragraph "D" on Page 6 of the said Agreement, I hereby confirm the Agreement, subject to the following conditions:

1. I agree to pledge United States Government Bonds in the amount of $300,000. face value, in lieu of market value as required by the terms of the Agreement, provided however, that the market value of the Bonds shall not be less than $285,000.

2. I agree to have the electrical work described in the attached estimate of the Northeast Electric Company commenced promptly after the consummation of the Agreement, and completed within a reasonable time thereafter.

3. In the event, under the formula referred to in the last paragraph of the first page of the said Agreement, I am required to make a cash payment of less than $75,000., I agree to invest the difference between the required cash payment and $75,000., not to exceed $15,000., in United States Government Bonds and to pledge them in the same manner as required by the Agreement, and provided relative the $300,000. face value Bonds indicated in paragraph 1 of this memorandum, to further secure the collateral note.

Please acknowledge your approval of the above by returning to me one signed and notarized copy of this memorandum.

/s/ Chester A. Snow

[Notarial Certificates, dated 7 August 1959]

EXHIBIT C

STATEMENT OF ACCOUNT

WITH

The Real Estate Title Insurance Company of the District of Columbia
The Columbia Title Insurance Company of the District of Columbia

1422 H STREET N. W., WASHINGTON 5, D. C.

①

THESE COMPANIES DO NOT ASSUME RESPONSIBILITY FOR TAXES OR ASSESSMENTS EXCEPT AS REPORTED ON THE TAX CERTIFICATE ISSUED BY THE ASSESSOR OF THE DISTRICT OF COLUMBIA.

CORRECTNESS OF INFORMATION FURNISHED THESE COMPANIES AS TO PRINCIPAL AND INTEREST ON DEEDS OF TRUST ON THIS PROPERTY ARE NOT GUARANTEED.

RECORDING FEES ESTIMATED AND ARE SUBJECT TO ADJUSTMENT AFTER RECORDING.

Settlement Case No. 91333 To Chester A. Snow DR.

In Re Purchase ~~xxxx~~ ~~xxxx~~ Stock of Lombardy, Inc. *Date* January 1st, 1960

	ASSETS:		
	Real Estate	$775,000.00	
	U.S. Bonds 61	95,250.00 ✓	
	U.S. Bonds 63.68	82,322.50 ✓	
	Cash	46,208.30 ✓	
	Accrued Interest	430.60 ✓	
	Pre-paid Insurance	1,466.44 ✓	
	Supplies	283.54 ✓	
	1,000,000.00 / 19,810.62 / 980,189.38		
	LIABILITIES:		
	Federal Tax Kluth, 1170		✓ 12,554.07
	D.C. Income Tax 1485.61-Dr.		✓ 1,551.29
	Fees and expenses		✓ 3,150.00
	Bills payable		✓ 650.00
	Bills		✓ 705.26
	Water Rent, utilities est.		✓ 1,200.00
	19810.62 ... McKane		
	Net Asset Value of Stock		981,140.76
		1,000,951.38	1,000,951.38
	46,208.30 / 19,810.62 / 26,397.68 net cash recd by CAS + paid to seller of stock.		
	Net Asset Value of Stock	981,140.76	
$775,000.00	Certificate of Title and Owners Policy	2,747.50	
	Tax Certificate	2.00	
	Preparing Trust	20.00	
	Recording Trust	18.00	
	Notary Fee	2.00	
	Settlement Fee	415.00	
	Preparing Deed	10.00	
	Recording Deed	5.00	
	Commission	25,000.00	
	Held for payment of Liabilities	19,810.62	
	321950		
	Deed of Trust Lot 824 Sq. 78		700,000.00
	Deposit	329,170.88	25,000.00
	Check Received Fisher Co.		46,208.30
	BALANCE DUE TO SETTLE ACCOUNT		257,962.58
		1,029,170.88	1,029,170.88

329170.88
− 3219.50
325951.38
− 19,810.62
306140.76 Recd in liquidation of Corp

COPY

[Exhibit K - p. 4]

LOMBARDY APARTMENTS, INC.

WASHINGTON, D. C.

1959 INCOME TAX RETURNS

BALANCE SHEETS

		DECEMBER 31, 1958		DECEMBER 31, 1959
ASSETS				
Accounts Receivable		$ 2,617.34		43,862.96
Prepaid Insurance		1,110.83		1,443.71
Accrued Interest Purchased		61.81		-
Building Improvements	384.00		384.00	
Building	350,000.00		350,000.00	
	350,384.00		350,384.00	
Less: Reser. for Deprec.	258,799.00	91,585.00	267,549.00	82,835.00
Boiler, Stoker, Refrig. Etc.	27,155.45		27,407.73	91415.83
Less: Reser. for Deprec.	16,098.75	11,056.70	18,826.90	8,580.83
Investments-United States Securities		184,000.00		184,000.00
Land		180,000.00		180,000.00
TOTAL ASSETS		470,431.68		500,722.50
LIABILITIES AND CAPITAL				
Accounts Payable		$ 393.50		$ 643.50
Capital Stock		156,585.00		156,585.00
Earned Surplus		313,453.18		343,494.00
TOTAL LIABILITIES AND CAPITAL		$ 470,431.68		$ 500,722.50

RECONCILLATION OF SURPLUS

BALANCE JANUARY 1, 1959	$ 313,453.18
Deduct:	
1958 Federal Income Taxes	4,678.54
	$ 308,774.64
Add:	
1959 Federal Net Income	34,719.36
BALANCE DECEMBER 31, 1959	$ 343,494.00

[Excerpt from Trial Brief]

(b) Interpretation of Local Taxing Statutes to Result in an Income Tax Liability When a Taxpayer Realizes no Profit is Contrary to the Constitution of the United States and the Amendments Thereto

As has been shown, the liquidation of the apartment house corporation by Petitioner, resulted in no gain to him. Hence, interpretation of a law which requires that he be taxed as if he received a gain, when he did not, is contrary to the Constitution of the United States and the amendments thereto. If the statute and rules are held to create a conclusive presumption of fact, contrary to fact, the rule of Heiner v. Donnan, 258 U.S. 312, 76 L.ed 772 (1932) is violated. If the measure of the tax is held to be the income theretofore earned by the corporation, rather than the income earned by the taxpayer, then the statute and rules violate Hoeper v. Tax Commission, 284, U.S. 206, 76 L.ed 248 (1931) because they measure a tax by the income of the corporate entity rather than the individual entity.

[Filed, Feb. 15, 1965]

FINDINGS OF FACT AND OPINION

Two taxes are under attack in these cases. In Docket No. 1934 Chester A. Snow, as an individual, appeals from the assessment of a deficiency in income tax, assessed upon what the assessing authority of the District of Columbia determined to be a dividend resulting from a corporate distribution. In the other case, Docket No. 1935, Chester A. Snow, trading as Chester A. Snow Rents, an unincorporated business, complains of a deficiency in franchise tax resulting from the disallowance of a deduction for depreciation.

The respondent contends that both taxes are valid.

The facts hereafter found relate to both taxes.

Findings of Fact

Most of the facts have been stipulated by the parties, and are found by the Court as stipulated. The Court finds additional facts as follows:

1. (a) The petitioner in Docket No. 1934 is an individual domiciled within the District of Columbia.

(b) The petitioner in Docket No. 1935 is the owner and operator of an unincorporated business known as "Chester A. Snow Rents" with its office at 710 Eighth Street, Northwest, Washington, D.C., wherein it carries on the business of apartment house rental.

2. These cases were filed on May 7, 1964.

Opinion

Docket No. 1934

The assessing authority of the District of Columbia assessed the petitioner, as an individual, a deficiency in income tax for the year 1960 in the amount of $17,264.64, plus interest in the amount of $3,021.31, or a total of $20,285.95. The deficiency was computed as follows:

Taxable income shown on return		$58,537.77
ADD: Additional income or unallowable deductions:		
Dividend from Lombardy, Inc.	$324,318.88	
Chester A. Snow Rents	967.32	
Salary Allowance & exemption	7,868.91	
Rental Income, North Portal Properties	10,837.70	
Contribution, Chilean Disaster Fund	1,000.00	
Casualty Loss	300.00	345,292.81
Total		$403,830.58
Revised tax liability		$19,816.53
LESS: Tax previously paid		2,551.89
Deficiency in tax		$17,264.64

While the petitioner in the petition filed herein protested several of the above detailed items of additional income and unallowable deductions, he abandoned the attack in respect to all, except "Dividend from Lombardy, Inc." Disposition by the Court will be limited to that item only.

The deficiency, as far as it relates to the dividend item, was assessed under the following sections of the District of Columbia Code, 1961 Edition:

> "47-1557a. Gross income and exclusions therefrom.
>
> "(a) The words 'gross income' include * * * income derived from * * * dividends * * *."
>
> "47-1551c. General definitions.
>
> * * *
>
> "(m) The word 'dividend' means any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits, or surplus (other than paid-in surplus), whenever earned by the corporation and whether made in cash or any other property (other than stock of the same class in the corporation if the recipient of such stock dividend has neither received nor exercised an option to receive such dividend in cash or in property other than stock instead of stock) and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation:"

On July 17, 1959, Arthur R. Guy was the owner of 100 shares of the capital stock of Lombardy, Inc., a Delaware corporation, which was the entire issue. The stock was issued either to Guy, or to his predecessor stockholder or stockholders for $156,585.00. On July 17, 1959, Guy entered into a contract with the petitioner, by which he agreed to sell his stock to the petitioner for $975,000, payable as follows: $75,000 in cash and a promissory note of $900,000, secured by certain securities and by a deed of trust on a piece of real estate known as "Lombardy Apartments", which the petitioner expected to receive ultimately as stockholder distributee of Lombardy, Inc., when he should have acquired the stock of that company from Guy.

On January 7, 1960, the above described transaction was closed. The petitioner made the cash payment as required by the contract, deposited securities of $200,000, and executed a note for $700,000 and a deed of trust on Lombardy Apartments securing the same. Guy transferred his 100 shares of the capital stock of Lombardy, Inc. to the petitioner. The petitioner then became the sole stockholder of Lombardy, Inc. On January 7, 1960, the Board of Directors of that corporation held a meeting, whereat a resolution providing for dissolution of the corporation and distribution of all its assets to the petitioner, as the sole stockholder, was adopted. On the same day the petitioner signed a paper, designated "Unanimous Consent to Dissolution", in which he consented to the dissolution. The articles of dissolution were transmitted to the office of the Secretary of the State of Delaware, who on January 8, 1960, approved the dissolution and issued a certificate thereof. A deed from Lombardy, Inc. to the petitioner dated January 7, 1960, and conveying Lombardy Apartments to the petitioner was executed by the corporation and recorded on January 11, 1960 in the office of the Recorder of Deeds in Liber 11365 at folio 94. Immediately thereafter the above mentioned deed of trust, signed by the petitioner and his wife, and securing the promissory note of $700,000, was recorded in the office of the Recorder of Deeds in Liber 11365 at folio 96.

The Lombardy Apartments was the only piece of real estate owned by Lombardy, Inc. The apartment building was constructed on Original Lot 7, part of Original Lot 6 and part of what is called "Alley Closed" in Square 78, all of which is designated for purposes of taxation as "Lot 824 in Square 78". In addition to the described real estate there were distributed by Lombardy, Inc., to the petitioner, as its sole stockholder, the assets following:

United States Bonds (61)	$95,250.00
United States Bonds (63 - 68)	82,312.50
Cash	46,208.30
Accrued Interest	430.60
Prepaid Insurance	1,466.44
Supplies	283.54

The parties have stipulated that at the time of the dissolution of Lombardy, Inc. the "fair market value" of the real estate of the petitioner, represented by Lombardy Apartments, and hereinafter so called, was $775,000.00, which value, of course, was not realized, but is a mere estimate of what it would bring in a fair sale. It apparently cost the corporation $530,384.00, that is to say, $350,384 for the improvements (apartment building) and $180,000 for the land. At the time of the dissolution it was valued on the books and records of the company at $271,415.83, computed or determined as follows:

Building	$350,384.00	
Less Depreciation	267,549.00	$82,835.00
Boiler, etc.	27,407.73	
Less Depreciation	18,826.90	8,580.83
Land		180,000.00
Total		$271,415.83

At the time of the dissolution the books and records of Lombardy, Inc. showed the following:

Capital Stock	$156,585.00
Earned Surplus	343,494.00
Total	$500,079.00

The petitioner, therefore, received assets of the recognized or realized value of $500,079.00, upon the dissolution of Lombardy. While assets of that recognized value were distributed to him, all of it was not a taxable dividend. The statute provides for the subtraction of what therein is called "paid-in surplus", which has been inerpreted to mean capital invested or paid in to the corporation by stockholders, in other words, the amount paid for capital stock. The designation implies the financial relationship between a stockholder and the corporation, and that the money or amount involved was "paid-in" to the corporation. In this instance the amount of "paid-in surplus" or the amount paid for capital stock was $156,585.00. That amount of the distribution, therefore, was not taxable to the distributee.

The receipt of the earned surplus of $343,494 was another matter. Under the definition of "dividend" in Section 47-1551c(m), quoted above, the amount received was a dividend and taxable as such. Berliner v. District of Columbia, 103 U.S. App. D.C., 351, 258 F.2d 651, 86 W.L.R. 456. The unrealized value of the assets distributed was not a taxable dividend. District of Columbia v. Oppenheimer, 112 U.S. App. D.C. 239, 301 F.2d 563, 90 W.L.R. 559.

The deficiency here assailed was based upon the assessing authority's determination that a dividend in the amount of $324,318.88, represented by the net amount of earned surplus of Lombardy, Inc., was received by the petitioner. That amount was computed as follows:

Earned Surplus at Date of Liquidation	$343,494.00
Less: Expenses (relating to the transaction)	19,175.12
Dividend	$324,318.88

The Court must rule that the assessment was valid.

The petitioner, as did the taxpayers in the Berliner case, seeks to have the distribution considered as a disposition of his stock in Lombardy, Inc., or as some form of a capital transaction, as permitted by the Federal Law. The District's law, however, is substantially different. What the petitioner really asks is that the term "paid-in surplus" be construed to mean what he paid Guy for the Lombardy, Inc. stock. In support of that contention the petitioner would have the Court distort Section 47-1557a(a) of the Code, and interpret it to mean that income from dividends is not taxable except to the extent that it represent or reflect gain. The section does provide that "The words 'gross income' include gains and profits", but it does not state from what source and specifically does not state that the "gains and profits" mentioned are from dividends. After providing that gross income includes gains and profit, it states that the words "gross income" includes income derived from several forms of labor, activities and property, including dividends. Those sources of income are in no way related to gain or profits. For in-

stance the phrase "and income derived from salaries", immediately following the provision about "gains and profits", is not to be interpreted to mean that "income derived from salaries" is not taxable, except to the extent that it represent or reflect gains or profits. The same is true in respect of "rent, royalties, interest, dividends, securities". (Emphasis supplied.)

The same contention here made by the petitioner was considered and disposed of adversely thereto by this Court in Dinkin v. District of Columbia, 89 W.L.R. 1293, C.C.H.-D.C. Par. 200-002 (Opinion 987). In that case the original stockholder, L. S. Jullien, acquired shares of stock in a corporation for $3,680.16. He subsequently sold that stock to Max Dinkin for $9,421.00. About 23 years thereafter the corporation was dissolved and distributed its assets of the value of $30,090 to Dinkin as the sole stockholder. Dinkin and his wife filed a joint income tax return, in which they reported a taxable dividend growing out of the corporate distribution, computed by deducting from the $30,090 the sum of $9,421.00, the amount which he had paid Jullien for the stock. The assessing authority rejected the computation and determined that the only amount which was properly deductible was what Jullian, the original stockholder, had paid the corporation for the stock; and assessed a deficiency accordingly. The Dinkins appealed from the assessment to this Court, which affirmed the assessment and held as follows:

> "The assessing authority of the District of Columbia considered or determined that the paid-in surplus of the corporation in relation to the stock here involved was what was received by the corporation from L. S. Jullien upon the issuance of the stock to him, that is to say, $3,680.16; and limited the deduction to that amount. On the other hand, the petitioners contend that the amount which the petitioner, Max Dinkin, paid Mr. Jullien for the transfer or assignment of the stock, that is to say, $9,421.00 represented paid-in surplus, and should have been deducted from the amount that the petitioner received upon dissolution of the corporation.

"The Court must hold that the assessment was proper. Berliner v. District of Columbia, 103 U.S. App. D.C. 351, 258 F.2d 651, 86 W.L.R. 456. The sum of $3,680.16, and that only, was the paid-in surplus in relation to the 51 shares of stock which the petitioner, Max Dinkin, held."

Guy, who wanted to convert his holdings into cash or a more liquid state, evidently knew or was advised that, if he had sold the assets of Lombardy, Inc. instead of the capital stock to the petitioner, the corporation would have realized the enhanced value of the assets; and that the $975,000 less the "paid-in surplus" of $156,585.00 would have been a taxable dividend when distributed to him under the decision in the Berliner case.[1] The gain he made on the sale of the stock to the petitioner was not taxable, because he had held the stock for more than two years. That was, no doubt, why he insisted upon selling the stock to the petitioner, and putting the petitioner in his, Guy's shoes. At any rate, the petitioner was the sole stockholder of Lombardy, Inc. at the time of its dissolution. He received all of its assets. He made his bed and must lie in it. The plain language of Section 47-1551c(m) does not permit any interpretation other than one imposing on the petitioner the legal obligation to pay an income tax on the dividend of $343,494.00 represented by the earned surplus of Lombardy, Inc., in that amount. Berliner v. District of Columbia, supra; Dinkin v. District of Columbia, supra; Uline v. District of Columbia, 91 W.L.R. 1863; Rafferty v. Comptroller of the Treasury, 228 Md. 153, 178 A.2d 896; United States v. Phellis, 257 U.S. 156, 42 S.Ct. 63, 66 L.Ed. 180. In computing the deficiency the assessing authority deducted an item of expenses in the amount of $19,175.12 from the earned surplus of $343,494 and thus determining the dividends to be $324,318.88. That was not proper. The expenses were not incurred in relation to the distribution, but were a capital expenditure in connection with the acquisition of the stock. Since the respondent does

[1] 103 U.S. App. D.C. 351, 258 F.2d 651, 86 W.L.R. 456.

not ask for an increase of the assessment, the Court will not disturb the computation.

In accordance with its custom, prompted by the unsettled matter of the Court's status, it will not decide the constitutional question presented. It does, however, here note that the constitutional question was here raised by the petitioner.

Docket No. 1935

This portion of the opinion is addressed to the appeal from the assessment of a franchise tax measured by net income, and assessed against the petitioner, as owner and operator of an unincorporated business, that is to say, the business of owning and operating an apartment house. Most of the facts recited in the preceding portion of this opinion are pertinent here, and are by reference considered as stated herein.

Apparently from the record, when the petitioner acquired Lombardy Apartments by distribution from Lombardy, Inc., he began its operation on his behalf, which constituted an unincorporated business within the meaning of the District of Columbia Income and Franchise Tax Act of 1947 (Chapter 15 of Title 47, D. C. Code, 1961 Edition). In that capacity he filed a franchise tax return and paid a franchise tax for the calendar year 1960. In computing the franchise tax paid by him for that year the petitioner deducted from gross rentals from Lombardy Apartments an item of depreciation in the amount of $26,162.52. Such amount for depreciation was determined or computed by the petitioner in the manner following: he determined that Lombardy Apartments have a fair market value of $803,219.50; he apportioned that value between the building and the land as follows: 81.43[2] per centum or $654,062.23 to the building, and 18.57 per centum or $149,157.27 to the land; and he then determined or considered that the building would be exhausted or obsolete in twenty-five years. As a result he deducted from gross rent-

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[2] Percentage used by assessing authority in assessing real estate tax, 1958-1959.

als an amount equal to four per centum of the value which he had assigned or apportioned to the building, that is to say, $26,162.52.

The assessing authority rejected the petitioner's computation of the deduction for depreciation, and determined that the correct basis for depreciation, was the net value [3] assigned to the building on the books and records of Lombardy, Inc., at the time of the dissolution, that is to say, the amount of $91,415.83.

Both the petitioner and the assessing authority were in error. The correct basis for depreciation was that portion of the total of the amount of the paid-in surplus [4] and the amount of the earned surplus ($156,585 + $343,494 = $500,079), which was assignable or allocable to, or represented by a building, known as Lombardy Apartments. Oppenheimer v. District of Columbia, 92 W.L.R. 799, 804. The only asset distributed to the petitioner which had unrealized appreciation of value was Lombardy Apartments. The other assets had no appreciation or increase, or had diminution[5] of value. The value of those other or last mentioned assets totaled $226,951.38, leaving the realized value of Lombardy Apartments the difference, or $273,127.62. That amount, of course, was the realized value of both the building and the land. Since the land was not subject to depreciation, there should have been apportioned to the building the portion of the realized value represented thereby.

The petitioner in apportioning value between the depreciable portion (the building) and the land of Lombardy Apartments used the apportionment percentage employed by the assessing authority of the District in assessing a real estate tax for the year immediately preceding the date of the transaction here involved (January 7, 1960), that is to

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[3] Cost less the reserve for depreciation.

[4] The amount paid the corporation for the capital stock.

[5] United States Bonds had depreciated from $364,000 to $177,562.50.

say 81.43 per centum to the building and 18.57 per centum to the land; and determined that the annual depreciation of the building was 4 per centum of its value. The assessing authority in computing the deficiency here under attack used the same percentage in determining the annual depreciation of the building. The Court believes that 81.43 per centum of the value of Lombardy Apartments, or $257,598.21 should be apportioned or allocated to the building, and that the annual depreciation of its value was reasonably 4 per centum thereof, or $10,303.93. The correct amount of franchise tax for the year 1960 is computed as follows:

Loss Reported (D.C. Operations only		-$8,161.32
Unallowable Depreciation		
Amount Taken	$26,162.52	
Amount properly allowable	10,303.93	15,858.59
Revised Amount of Income		$7,697.27
Less: Salary Allowance	2,865.91	
Exemption	5,000.00	7,865.91
	(Loss)	-$ 168.64

No deficiency was, therefore, properly assessable against the petitioner, as an unincorporated business. The Assessment and collection of a deficiency in the amount of $323.78 was erroneous.

Conclusion

For the reasons stated the Court holds as follows:

Docket No. 1934. That a deficiency in income tax for the calendar year 1960, in the amount of $17,264.64, plus interest in the amount of $3,021.31, or a total of $20,285.95, was not erroneously assessed against and collected from the petitioner as an individual, and must be affirmed; and that the petitioner is not entitled to any refund thereof.

Docket No. 1935. That a franchise tax for the calendar year 1960, in the amount of $323.78, plus interest in the amount of $56.66, or a total of $380.44, was erroneously assessed against, and collected from the petitioner, as an unincorporated business, and must be cancelled,

and that the petitioner is entitled to a refund thereof, with interest thereon at the rate of 4 per centum per annum from March 16, 1964, to the date of payment of refund.

Decisions will be entered in accordance with this opinion.

Jo. V. Morgan
Judge

[Filed Mar. 2, 1965]

AMENDMENT TO OPINION

The Opinion entered herein on February 15, 1965 is amended by striking out the figure $75,000 in the 7th. line of the 4th. paragraph (page 3) of the Opinion and substituting in lieu thereof the figure $275,000; and by striking out the figure $900,000 in the 8th. line of the 4th. paragraph (page 3) of the Opinion and substituting in lieu thereof the figure $700,000.

The Opinion is further amended by striking out in paragraph 15, pages 7 and 8 of the Opinion the following:

> "Guy, who wanted to convert his holdings into cash or a more liquid state, evidently knew or was advised that, if he had sold the assets of Lombardy, Inc. instead of the capital stock to the petitioner, the corporation would have realized the enhanced value of the assets; and that the $975,000 less the 'paid-in surplus' of $156,585.00 would have been a taxable dividend when distributed to him under the decision in the Berliner case.[1] The gain he made on the sale of the stock to the petitioner was not taxable, because he had held the stock for more than two years. That was, no doubt, why he insisted upon selling the stock to the petitioner, and putting the petitioner in his, Guy's shoes. At any rate, the petitioner was the sole stockholder of Lombardy, Inc. at the time of its dissolution."

And substitute in lieu thereof the following:

"The petitioner was the sole stockholder of Lombardy, Inc. at the time of its dissolution."

The Opinion is further amended by striking out footnote (1) on page 8 of the Opinion and by changing the numbers of the remaining footnotes accordingly.

Jo. V. Morgan
Judge

[Filed Feb. 15, 1965] [Docket No. 1934]

DECISION

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is, by the Court this 15th. day of February, 1965.

ADJUDGED AND DETERMINED, That a deficiency in income tax for the calendar year 1960, in the amount of $17,264.64, plus interest in the amount of $3,021.31, or a total of $20,285.95, was not erroneously assessed against and collected from the petitioner as an individual, and is hereby affirmed; and that the petitioner is not entitled to any refund thereof.

Jo. V. Morgan
Judge

[Filed March 3, 1965] [Docket No. 1934]

PETITION FOR REVIEW OF A DECISION OF THE DISTRICT OF COLUMBIA TAX COURT

To the Honorable Chief Judge and Circuit Judges of the United States Court of Appeals for the District of Columbia Circuit:

1. Chester A. Snow petitions for a review by the United States Court of Appeals for the District of Columbia Circuit, of a decision of the District of Columbia Tax Court made in the above-entitled case.

2. The decision of which review is sought affirmed an assessment of a deficiency in income tax for the year 1960 against petitioner, an individual.

3. The decision of the Tax Court was entered on February 15, 1965.

KING & NORDLINGER

Bernard I. Nordlinger
Attorneys for Petitioner

[Docket No. 1935]

DISTRICT OF COLUMBIA TAX COURT

Date	Proceedings	Memorandum
		Franchise Tax $380.44
1964		
May 7	Petition filed — Taxpayer notified Corporation Counsel and Finance Office served.	
Sept 16	Hearing set for Sep 30 — Certificate of service.	
Sept 21	Motion for continuance —	
Sept 22	Motion granted — Hearing continued to Oct 20. Certificate of service.	
Oct 13	Hearing continued to Nov 10/	
Nov 24	Hearing Henry E. Wixon, Esq., for District. Trial Brief filed.	
Dec 7	Motion for extension of time within which to file brief for respondent — Granted — Certificate of service.	
Dec 23	Motion for extension of time within which to file brief for respondent.	
Dec 24	Motion granted to Jan 4 — Certificate of service	
1965		
Jan 4	Brief for Respondent — Certificate of service.	
Jan 7	Reply brief of Petition — Certificate of service.	

Jan 15	Supplemental Stipulation.
Feb 15	Findings of Fact, Opinion Decision — Certificate of service.
Mar 2	Amendment to Opinion — Certificate of service.
Mar 3	Order for Consolidation of causes — Certificate of service.
Mar 3	Petition for Review — Certificate of service.
Mar 9	Designation of Record — Certificate of service.

[Filed May 7, 1964]

PETITION

[Docket No. 1935]

The above-named Petitioner appeals from an assessment of taxes against him and avers as follows:

1. Petitioner is an individual with residence at 4426 Cathedral Avenue, N.W., Washington, D.C. and office at 710 8th Street, N.W., Washington, D.C.

2. The tax in controversy is an Unincorporated Business Franchise Tax in the amount of Three Hundred Twenty-three Dollars and Seventy-eight Cents ($323.78) for the year ended December 31, 1960, plus interest of Fifty-six Dollars Sixty-six Cents ($56.66) for a total of Three Hundred Eighty Dollars Forty-four Cents ($380.44).

3. The notice of assessment (statement of taxes due) was dated March 13, 1964, as will appear from the copy thereof, hereto attached as Exhibit "A." The tax was paid by Petitioner on March 16, 1964. A copy of the notice of deficiency and the statement of method of computation thereof explaining the deficiency are attached hereto respectively as Exhibits "B" and "C."

4. The assessment of tax is based upon the following errors:

(a) Use of "net book value of assets received in liquidation" by the Government of the District of Columbia is not in conformity with the requirements of the statute because the taxpayer is entitled to an allowance for depreciation under Section 47-1557b(7) D.C. Code (1961)

reasonable in amount upon the basis provided for in Section 47-1583e. In turn, the basis set out in Section 47-1583e(a) is the cost of the particular assets to the taxpayer. The cost to the taxpayer of the particular assets, the Lombardy Apartments, sought to be depreciated in the case at bar was for the building acquired $654,062.23, not the "net book value of assets received in liquidation, $91,415.83" shown on the books of Lombardy, Inc., a corporation in liquidation.

(b) On or about January 1, 1960, Petitioner acquired all of the shares of stock of Lombardy, Inc., a corporation, which immediately liquidated and distributed to Petitioner all of its assets, including an apartment building. The District of Columbia erroneously used as a basis for depreciation the book value of the apartment building on the books of the corporation which had liquidated, rather than the cost of the apartment building to this Petitioner.

5. The facts upon which the Petitioner relies as a basis of this case are as follows:

(a) Petitioner paid the full and fair value for all of the shares of the stock of Lombardy, Inc. under an Agreement dated the 17th day of July, 1959, and an amendment thereto dated August 7, 1959. Pursuant to said Agreement, on January 1, 1960, a settlement under said contract for the purchase of the stock of Lombardy, Inc. was effected and the corporation immediately thereafter liquidated. This Petitioner thus obtained assets for which he paid full and fair value equal to the purchase price.

(b) The improved real estate constituting the Lombardy Apartment was acquired by Petitioner at a cost of $803,219.50, allocated according to 1960 assessed value for D.C. Real Estate Taxes, $149,157.27 for land, and $654,062.23 for building. Thus the cost to this taxpayer for acquisition of the building may be depreciated at the 4% rate claimed by the taxpayer; not the 4% of $91,415.83 claimed by the Government of the District of Columbia as the undepreciated value of assets on the books of Lombardy, Inc., the corporation which had liquidated.

WHEREFORE, Petitioner prays that this Court may hear the case and order a refund of Three Hundred Eighty Dollars Forty-four Cents ($380.44) with interest thereon to date of refund.

Chester A. Snow

KING & NORDLINGER

Bernard I. Nordlinger
Attorneys for Petitioner

DISTRICT OF COLUMBIA) SS:

CHESTER A. SNOW, being duly sworn says that he is the Petitioner above named; that he has read the foregoing Petition and is familiar with the statements contained therein; that he verily believes that the statements are true.

Chester A. Snow

[Exhibit A]

Paid under protest:

GOVERNMENT OF THE DISTRICT OF COLUMBIA
FINANCE OFFICE • Revenue Division

INCOME AND FRANCHISE TAX

COPY 1A - TAXPAYER'S COPY

TYPE TAX:
- I - Individual Income
- D - Declaration Payment
- H - Corporation
- J - Unincorporated Business
- F - Fiduciary
- E - Employer Withholding

ACCOUNT NUMBER	REF.	TYPE TAX	TAX YEAR	DATE
11120		J	1960	3/13/64

NAME AND ADDRESS		TOTAL TAX DOLLARS	TOTAL TAX CTS.	CREDIT DOLLARS	CREDIT CTS.	INTEREST TO	PAYMENT DUE DOLLARS	PAYMENT DUE CTS
Chester A. Snow Rents 710 - 8th Street, N. W., Washington, D. C.	 Int.	323 56	78 66			3/15/64	380	44

Interest on payment due at the rate of ½ of 1% per month or portion thereof must be added if not paid on or before the interest date shown on this bill. Late filing penalty is computed at 5% per month or portion thereof (maximum 25%), except type tax E which is a flat 25%.

Make check payable to D. C. TREASURER. Send check or money order to FINANCE OFFICE, REVENUE DIVISION, Municipal Center, Washington 1, D. C.

Your cancelled check is your receipt.

FFr 56 (9/60)

Interest at rate of ½ of 1% per month or portion thereof
from to

TOTAL PAYMENT DUE →

KEEP THIS COPY

380.44

4 7 5

3-26-64

D. C. Treasurer

PAID

PAID UNDER PROTEST

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Department of General Administration

Finance Office:
Revenue Division

[Exhibit B]

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

February 3, 1964

Mr. Chester A. Snow
T/A Chester A. Snow Rents
710 - 8th Street, N.W.
Washington, D.C.

Re: File No. U/B 11120 (WRE)

Dear Sir:

The examination by this office of your income and/or franchise tax return(s) for the year(s) ended December 31, 1960, indicates that the adjustment of your tax liability, as shown in the accompanying statement, is warranted.

IF YOU AGREE to the adjustment in tax as shown in the accompanying statement, the enclosed form of waiver should be executed and forwarded to this office promptly, in order to permit the early assessment of the additional tax and to stop the accumulation of interest. Interest will cease, as of date of assessment, upon payment of amount due to the D.C. Treasurer, within ten (10) days from date of assessment.

IF YOU DO NOT AGREE to the proposed adjustment, you may file a protest with this office, within thirty (30) days from the date of this letter, stating the grounds for your exceptions. Any protest so filed will have careful consideration and, if you so request, an opportunity for a hearing in this office will be granted you prior to final determination of any deficiency in tax against you.

Should you fail to file either the enclosed form of waiver or a written protest with this office within the thirty-day period mentioned, final determination of your tax liability will be made and notice and de-

mand will be sent you in accordance with the provisions of law applicable to the assessment and collection of income and/or franchise tax deficiencies.

Yours very truly,

Ben A. Barsky
Supervisory Tax Auditor
Income and Franchise Tax Section

Enclosures:

Statement
Form of Waiver

[Exhibit C]

CHESTER A. SNOW RENTS

Chester A. Snow
710-8th Street, N.W.

UB File 11120 WRE

Unincorporated Business Franchise Tax

Calendar Year		1960
Loss Reported (D.C. Operations Only)		$8161.32
Plus: Unallowable Depreciation		22505.89
Revised Profit		$14344.57
Less: Salary Allowance	$2868.91	
Exemption	5000.00	7868.91
Taxable Income		$6475.66
Tax (a) 5% (Deficiency)		323.78
Net Book Value of Assets Received in Liquidation		$91415.83
Allowable Depreciation (a) 4%		3656.63
Depreciation Taken		26162.52
Depreciation Disallowed		$22505.89

[Petitioner's Exhibit 1] STIPULATION

[Docket No. 1935]

It is hereby stipulated among the parties to this cause, through their respective counsel of record, that the following facts are true and may be introduced in evidence without formal proof, and shall be considered as having been duly proved according to law for the purposes of this case and no other matter, pending or future:

1. On March 13, 1964, Notice of Assessment of a deficiency in income taxes for the year 1960 in the amount of $323.78, with interest in the amount of $56.66 was delivered to Petitioner. On March 16, 1964, Petitioner paid said tax and interest thereon under protest. A copy of the Notice of Assessment (Statement of Taxes Due) is attached to the Petition in Docket No. 1935, heretofore filed herein.

2. The Stipulation in Docket No. 1934 is hereby incorporated herein by reference for the same purpose and subject to the same conditions and limitations as set forth therein and herein.

3. (a) Upon dissolution of Lombardy, Inc. the journal entry made January 7, 1960, on the books of Chester A. Snow Rents reflected the following distribution received by him upon the liquidation of Lombardy, Inc.:

	Debit	Credit
Land — 2019 Eye St., N.W.	$149,157.27	$
Building	654,062.23	
U.S. Bonds at Market Value	177,562.50	
Cash Received and Paid Over to Seller	46,208.30	46,208.30
Accrued Interest Receivable on U.S. Bonds	430.60	
Prepaid Insurance	1,466.44	
Supplies — Janitor	283.54	
First Mortgage		700,000.00
Purchase Price Lombardy, Inc. Stock		282,962.58
TOTALS	$1,029,170.88	$1,029,170.88

(b) Respondent does not concede the foregoing entry was correct.

4. (a) The allocation of $149,157.27 to land and $654,062.23 to building was derived from allocating out of the total amount paid for corporation stock $803,219.50 to improve real estate. That amount was then allocated in the proportions of the July 1, 1959, D.C. Tax assessment to land and building. Petitioner thus on an allocated basis recorded in his books that he actually paid on or about January 7, 1960, $654,062.23 for said building constituting the Lombardy Apartments.

(b) Respondent does not concede that the foregoing method or entry was correct.

5. The undepreciated cost of the buildings and improvements of the Lombardy Apartments shown on the Balance Sheet of Lombardy, Inc. as at December 31, 1959, consisting of undepreciated cost of building and improvements at $82,835.00 and undepreciated cost of stóker, refrigerator, etc. at $8,580.83, constituted the undepreciated balance of the cost or book value of said improvements known as the Lombardy Apartments to said corporation, according to its books.

6. $26,162.52 constituted a fair and reasonable allowance for depreciation to Petitioner as deducted by him from gross income upon his return for the year 1960 only if Petitioner was correct in establishing $654,062.23 as a basis for depreciation of said building. In such case, Petitioner was correct in using the straight line method of depreciation at a rate of 4% per annum.

IN WITNESS WHEREOF, the parties hereto have caused these presents to be executed by their respective counsel of record.

KING & NORDLINGER

Bernard I. Nordlinger
Attorneys for Petitioner

Henry E. Wixon
Assistant Corporation Counsel, D.C.
Attorney for Respondent

[Docket No. 1935]

SUPPLEMENTAL STIPULATION

It is hereby stipulated by and between counsel for petitioner and counsel for respondent in the above-entitled case as follows:

1. The values of land and building pertaining to Lot 824 in Square 78 in the District of Columbia as determined by the District for purposes of assessment and taxation, and the percentages which the value of each of such items bears to the total value of these items for such purpose are as follows:

	Value 1956-1959	Per Cent of Total	Value 1960	Per Cent of Total
Land	$ 70,694.00	18.570	$ 97,884.00	23.998
Building	310,000.00	81.430	310,000.00	76.002
Total	$380,694.00	100.	$407,884.00	100.

2. 81.430 per cent of $803,219.50 (see paragraph 4(a) of Stipulation in Docket No. 1935) was calculated by petitioner to determine his cost of building for depreciation purposes.

3. The deficiency in tax determined by the District of Columbia in respect of the unincorporated business franchise tax liability of petitioner for the calendar year 1960 was determined and communicated to petitioner as set forth in Exhibits A and B to this Stipulation.

Bernard I. Nordlinger
Attorney for Petitioner

Chester H. Gray
Corporation Counsel, D.C.

Henry E. Wixon
Assistant Corporation Counsel, D.C.
Attorneys for Respondent

[Filed Feb 15, 1965] [Docket No. 1935]

DECISION

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is, by the Court this 15th day of February, 1965,

ADJUDGED AND DETERMINED, That a franchise tax for the calendar year 1960, in the amount of $323.78, plus interest in the amount of $56.66, or a total of $380.44, was erroneously assessed against, and collected from the petitioner, as an unincorporated business, and is hereby cancelled; and that the petitioner is entited to a refund thereof, with interest thereon at the rate of 4 per centum per annum from March 16, 1964, to the date of payment of refund.

[Certificate of Service]

Jo V. Morgan
Judge

[Filed March 3, 1965] [Docket No. 1935]

PETITION FOR REVIEW OF A DECISION OF THE DISTRICT OF COLUMBIA TAX COURT

To the Honorable Chief Judge and Circuit Judges of the United States Court of Appeals for the District of Columbia Circuit:

1. Chester A. Snow petitions for a review by the United States Court of Appeals for the District of Columbia Circuit, of a decision of the District of Columbia Tax Court made in the above-entitled case.

2. The decision of which review is sought affirmed an assessment of a deficiency in income tax for the year 1960 against petitioner, an individual.

3. The decision of the Tax Court was entered on February 15, 1965.

KING & NORDLINGER

Bernard I. Nordlinger
Attorneys for Petitioner

BRIEF FOR APPELLANT

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19,232

CHESTER A. SNOW,
Appellant,

v.

DISTRICT OF COLUMBIA,
Appellee.

No. 19,233

CHESTER A. SNOW, t/a
CHESTER A. SNOW RENTS,
Appellant,

v.

DISTRICT OF COLUMBIA,
Appellee.

Appeal From the Tax Court for the District of Columbia

BERNARD I. NORDLINGER
WILLIAM P. DAISLEY
419 Southern Building
Washington 5, D.C.

WILLIAM T. PLUMB, JR.
Chanin Building
Washington, D.C.
Attorneys for Petitioner

KING & NORDLINGER
419 Southern Building
Washington 5, D.C.
Of Counsel

HOGAN & HARTSON
Chanin Building
Washington, D.C.
Of Counsel

QUESTIONS PRESENTED

1. Whether a taxpayer who purchases all of the outstanding shares of stock of a corporation for the purpose of acquiring its principal asset, an apartment house, and who therefore concurrently with purchase of the shares dissolves the corporation, realizes income subject to District of Columbia Income Tax even though the fair value of the assets received upon liquidation and dissolution of the corporation is not in excess of the cost of his stock.

2. Whether amounts distributed in complete liquidation of a corporation, to the extent that those amounts represent corporate earnings but do not exceed the cost of the stock, are properly includible in the stockholder's gross income as a dividend under Section 47-1551c (m) of the District of Columbia Code (1961).

3. Assuming that dividend income is held to have been realized in the circumstances stated, whether the taxpayer suffered a deductible loss on the liquidation of the corporation, to the extent that the non-dividend portion of the distribution failed to return his cost.

4. Whether a taxpayer who purchases all of the outstanding shares of stock of a corporation for the purpose of acquiring its principal asset, an apartment house, and who therefore concurrently with purchase of the shares dissolves the corporation, is entitled to an annual allowance for depreciation based upon the value of the property when distributed in liquidation or the net amount paid for the shares of stock, or whether the taxpayer is limited (as the Tax Court held) to an allowance for depreciation based upon the paid-in and earned surplus of the corporation at the time of the acquisition of the shares and dissolution of the corporation.

TABLE OF CONTENTS

TABLE OF CITATIONS

Cases:

Statutes and Regulations:

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* Cases chiefly relied upon are indicated by asterisks.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19,232

CHESTER A. SNOW,
Appellant,

v.

DISTRICT OF COLUMBIA,
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No. 19,233

CHESTER A. SNOW, t/a
CHESTER A. SNOW RENTS,
Appellant,

v.

DISTRICT OF COLUMBIA,
Appellee.

BRIEF FOR APPELLANT

JURISDICTION OF THE COURT

Jurisdiction of this Court is based upon D. C. Code 47-2404 (1961)[1] the decisions of the Tax Court of the District of Columbia having been filed on February 15, 1965, (JA 42, 53) and the Petitions for Review having been filed on March 3, 1965, (JA 42, 53) within the required thirty-day period. The appeals were docketed in this Court on March 18, 1965, within the time required by Rule 36(b), which

[1] All references are to 1961 edition of the D. C. Code unless otherwise indicated.

fixes the time for filing and docketing in this Court under Rule 73(g) of the Federal Rules of Civil Procedure, there having been no shorter time fixed by the Tax Court. The District of Columbia Tax Court had jurisdiction under Sec. 47-1593, the Notice of Assessment having been dated March 13, 1964, the tax paid March 16, 1964, and the Petitions filed May 7, 1964, in each case (JA 2, 5, 44, 47) within the required ninety-day period.

STATEMENT OF THE CASE

Appellant hereinafter will be called "petitioner" or "taxpayer" and Appellee will hereinafter be called "respondent."

These consolidated causes arise from the liquidation and dissolution of a corporation, Lombardy, Inc., all the shares of which were purchased by petitioner, immediately prior to such liquidation and dissolution, for the express purpose of acquiring an apartment house owned by the corporation. In Docket No. 19,232, assessment of a deficiency in District of Columbia individual income tax for the year ended December 31, 1960 (Sec. 47-1557 *et seq.*) resulted from petitioner's receipt of the corporate assets in liquidation, which the Finance Officer and the Tax Court determined to be taxable as dividend income, under the definition contained in Sec. 47-1551c(m). In Docket No. 19,233, the Finance Officer assessed a deficiency in unincorporated business franchise tax (Sec. 47-1574 *et seq.*) for the same year, based upon disallowance of petitioner's deduction for depreciation of the assets acquired upon liquidation, measured by <u>his</u> cost of the stock. The Finance Officer limited petitioner's basis to an amount equal to <u>the corporation's</u> adjusted basis for the property. The Tax Court allowed a basis for depreciation measured instead by the paid-in and earned surplus of the corporation, rejecting the positions of both the petitioner and the respondent in this regard.

On or about July 17, 1959, petitioner entered into an Agreement with one Arthur R. Guy to purchase all of the outstanding shares of the common stock of Lombardy, Inc., a Delaware corporation (JA 16). The Agreement pursuant to the terms of which petitioner acquired the stock (JA 19 *et seq.*) provided for payment of $975,000.00 as the total price of all of the outstanding shares of stock,

> ". . . with an adjustment of that amount upward or downward for the difference by which the cash, receivables, prepaid expenses and securities owned by said Lombardy, Inc., less accruble [accruables] and payables are more or less than Two Hundred Thousand Dollars ($200,000); the value of the receivables and securities shall be determined by the actual market value as of the date of settlement."

Petitioner was to "pay the real estate agents their brokerage or commission." The commission amounted to $25,000.00 (JA 28). Hence, petitioner paid $1,000,000.00, subject to adjustment, for all of the outstanding shares of stock of Lombardy, Inc. He paid a deposit (JA 20) of $25,000.00 at the time of execution of the Contract and agreed to make settlement "on or before January 7, 1960." At settlement, petitioner agreed

> ". . . to pay Fifty Thousand Dollars ($50,000) additional in cash, so that the total cash payments including the aforesaid deposit, shall be Seventy-five Thousand Dollars ($75,000). . ." (JA 20)

In addition, petitioner agreed "to pay cash of Two Hundred Thousand Dollars ($200,000) more or less, . . ." (JA 20) in accordance with the formula for adjustment of the price aforesaid and indented above. Thus the transaction was for petitioner to pay the seller of the shares of corporate stock approximately $300,000.00 in cash, consisting of the $200,000.00 cash value of assets of the corporation (to be adjusted as aforesaid) and $100,000.00 additional made up of three (3) items:

Deposit	-	$ 25,000.00
At Settlement	-	50,000.00
Commission	-	25,000.00
		$100,000.00

The remainder of the price of $700,000.00 was to be evidenced by a collateral note of $700,000.00 (JA 41) in the form attached to the Agreement (JA 25), to be "secured by a first trust note in favor of the seller recorded against the Lombardy Apartments hereinbefore described, in the full amount of said collateral note, and said collateral note" was to be further secured by "Three Hundred Thousand Dollars ($300,000) in United States Government Bonds," all to "be placed in the National Bank of Washington for collection" (JA 21). Petitioner did not have the right to accelerate maturity of the first trust note and the collateral note unless he divested "himself of title to the Lombardy Apartments, or in the event of his decease" and "(t) his provision likewise shall be inserted in the deed of trust" (JA 22). Other provisions (JA 22, 23, 24) also refer to the Lombardy Apartments real estate, making it clear that the parties were dealing with the apartment house rather than with shares of stock. Indeed, at the trial, the learned Trial Judge was of that view: (JA 10)

"BY MR. NORDLINGER:

Q. Referring to the contract, Mr. Snow, how did it happen that you signed it in that form? Tell the Court about it.

MR. WIXON: I object. It is immaterial.

THE COURT: In what respect? I mean there ought to be some reference to the terms of the contract to see if I can understand his testimony. You want the whole contract, why he entered the contract?

MR. NORDLINGER: Yes, sir.

THE COURT: I can answer that myself. He wanted to buy the building.

MR. NORDLINGER: That is exactly what we are trying to prove.

THE COURT: Well he wanted to buy the building. He wanted to get the building.

MR. NORDLINGER: If this is stipulated, then we do not need further testimony from the witness.

THE COURT: He wanted to get the building, but the point is how did he do it? Did he get it by going to buy the building or did he use some other method?

(Emphasis added)

* * *

(JA 11)

THE COURT: The intention was to buy the stock and I suppose if he got the stock, he could finally take and buy the building. I think that is plain.

MR. NORDLINGER: Yes, sir, that is what I am trying to prove. If it is plain to your Honor he had the intention of purchasing the land and building and not the stock --

THE COURT: I think it irresistible. Here is a man that buys the stock and then turns around and dissolves the corporation and takes the assets, or whatever he takes, and that is what he intends to do, wasn't it?

(Emphasis added)

* * *

(JA 12)

MR. NORDLINGER: We asked the District of Columbia to stipulate that the sole purpose of petitioner in entering into the contract for the purchase of the

shares of stock was for the purpose of acquiring the land and building. The District would not so stipulate. Accordingly, I called the witness to prove that is what he intended to do.

THE COURT: I think if the facts as you recite are so, I don't think there is any dispute about it. What he wanted to do was get the building. What steps he took would make him liable for taxes, that is something else again." *(sic)*

(Emphasis added)

On or about January 7, 1960, settlement as of January 1, 1960, under said Contract was held at the Real Estate and Columbia Title Insurance Company (JA 16). The settlement sheet (JA 28) shows a total of $1,029,170.88 paid by petitioner. Of this amount, $700,000.00 was in the form of the collateral note mentioned above, for which in turn was pledged a note of $700,000.00 secured by first deed of trust and the Government Bonds mentioned above.

At time of settlement for the purchase of the shares of stock, the stock was delivered to petitioner with Powers of Attorney attached, and the corporation immediately liquidated (JA 16). All of its assets, including the corporate cash and United States Bonds were distributed to petitioner, who thereupon proceeded to perform the contract by the delivery of the necessary collateral note, deed of trust note, and acceptance of a deed from the liquidating corporation, dated January 7, 1960, which conveyed the Lombardy Apartments in this City to petitioner. (JA 17)

"The fair market value of the assets received by petitioner upon liquidation of said corporation was not in excess of the cost to petitioner of the stock of said corporation." (JA 17) (JA 50)

The total amount paid for land and building was $803,219.50, (JA 28, bottom half) as follows:

Real Estate	$775,000.00
Incidental Expenses (script summary)	3,219.50
Commission	25,000.00
	$803,219.50

Of this amount, petitioner allocated $149,157.27 to land and $654,062.23 to building (JA 38, note 2, 51). The allocation to land and building was the result of applying to the total cost of land and building, the same percentage that the Tax Assessor of the District of Columbia applied to land and building respectively, in the proportions of the July 1, 1959, real estate tax assessment.

From the foregoing, then, it is plain that petitioner did in fact pay $1,029,170.88 for the assets received from the corporation. Payment of said amount was made as follows (JA 28, 50):

Cash of corporation	$ 46,208.30
Bonds of corporation at market value	95,250.00
Bonds of corporation at market value	82,312.50
Deferred purchase money	700,000.00
Cash of petitioner	
Deposit	25,000.00
Commission	25,000.00
Cash after adjustments	55,400.08
	$1,029,170.88

Respondent, however, refused to view the transaction in the light of the foregoing facts. An income tax was assessed against petitioner as if he had received a dividend from the corporation concurrently liquidated at settlement in the amount of $324,318.88 (JA 7), namely

(JA 29) $343,494.00 earned surplus appearing upon the books of the corporation then dissolved, less expenses of the corporation assumed in the aggregate of $19,175.12. (JA 35).

In like manner, the learned Judge of the Tax Court sustained a disallowance of depreciation which Petitioner had computed according to his cost, on the ground that the

> ". . . correct basis for depreciation was that portion of the total of the amount of the paid-in surplus [the amount paid the corporation for capital stock on its original issue] and the amount of the earned surplus ($156,585 plus $343,494 equals $500,079), which was assignable or allocable to, or represented by a building, known as Lombardy Apartments." (JA 39) (Emphasis in original; words in brackets added)

and that thereafter the total amount so ascertained should be allocated to land and building in the same proportion or percentage (81.43%) that petitioner had originally used and had obtained from the percentage used by the Real Estate Tax Assessor (JA 38, note 2, 40).

Thus, it may be seen that petitioner was subjected to the measurement of income taxes in the first case by the use of profit theretofore earned by the corporation which was liquidated and dissolved, rather than by any realistic view of profit or gain or income he might have realized himself, which was zero. In the second case, in similar manner, petitioner was ordered to use as a basis for depreciation the amount of the paid-in and earned surplus of the corporation (properly allocated) rather than the cost of the land and building which he had incurred when he acquired it.

STATEMENT OF POINTS

1. A stockholder receiving proceeds of liquidation and dissolution of a corporation realizes no "income" when the fair value of the assets received upon liquidation and dissolution are not in excess of the cost of his stock.

2. It was not the intention of the Congress of the United States to levy an income tax upon residents of the District of Columbia for receipt of a "dividend" upon liquidation and dissolution of a corporation, simply because a stockholder receives sums shown on the books of the corporation as "earned surplus," when the amounts received by the stockholder from the corporation in property and money are not in excess of the cost of his stock.

3. An income tax levied upon sums described as "dividends" when the sums so received are not in excess of the cost of the stock owned by the stockholder and when no further sums are to be received by the stockholder from the corporation because of its liquidation and dissolution, is in violation of the Fifth Amendment to the Constitution of the United States.

4. An income tax levied upon a stockholder of a corporation when he received in liquidation and dissolution of the corporation money and property of a value not in excess of the cost of his stock, because the tax is measured by the earnings or surplus of the corporation in liquidation or dissolution, and not by the income or gain derived by the stockholder, is in violation of the Fifth Amendment to the Constitution of the United States.

5. If it should be held that the taxpayer realized dividend income to the extent of the earned surplus of the corporation distributed in liquidation, that amount cannot also be deemed a return of capital, and hence the taxpayer suffered a deductible non-capital loss on the final disposition of his stock in liquidation, to the extent that the non-divi-

dend portion of the distribution failed to return his cost. Since the aggregate distribution was no greater than the taxpayer's cost for the stock, the deductible loss exactly offsets any amount that may be held taxable as a dividend, and no income tax liability results from the transaction.

6. Where property and money are received by a stockholder in complete liquidation of a corporation, the basis of the property received is either its market value when distributed or the taxpayer's cost for his stock (reduced by the money distributed), and neither the corporation's adjusted cost for the property nor the amount of its invested capital and surplus have any relevance to the stockholder's basis.

7. Where the taxpayer bought stock of a corporation for the purpose of immediately obtaining its assets, by liquidation of the corporation, and he did so liquidate the corporation, the amount paid for the stock (reduced by the money distributed) is his basis for the property so acquired.

SUMMARY OF ARGUMENT

The primary issues in these cases are simply stated as follows: (1) Can a net income tax be levied upon the proceeds of a transaction from which the taxpayer realizes no more than he had invested, and from which he derives no income or profit? (2) Should a reasonable allowance for depreciation be based on the taxpayer's own investment in property rather than on the investment made in another entity by others?

It is well established in federal tax cases that, when one buys stock for the express purpose of obtaining the assets of the corporation by immediate liquidation (as in this case), the transaction will be viewed as in substance a purchase of the underlying assets, and

statutory provisions normally governing the taxability of distributions in liquidation and the basis of the property distributed will not be applied. In such a case, the petitioner could realize no taxable income from the purchase of assets, and his cost basis for the assets would be an allocable portion of the amount he paid for the stock.

If that principle is accepted and deemed applicable under District law, it is necessary to go no further than part 1 of the Argument, because discussion of the statutes relating to liquidating distributions becomes irrelevent. However, because the Tax Court rejected that basic principle, and relied upon a misconstruction of the statutory provisions and decisions relating to corporate liquidations, it is necessary to discuss them at some length.

The District of Columbia Income and Franchise Tax of 1947 defines a dividend to include a distribution of corporate earned surplus at liquidation; but it taxes such a dividend only if the recipient realizes income therefrom. There can be no "gross income" derived from a distribution unless provision is made for tax-free recovery of cost out of gross receipts. Where a going concern makes a dividend distribution, the cost of the recipient's stock is irrelevant because there has been no closed transaction with respect to the stock, and it is entirely conjectural whether the stockholder will ultimately realize a loss as a result of the depletion of corporate assets by the dividend payment. In contrast, a distribution in complete liquidation is the last amount the stockholder can ever recover from the stock, and his cost must be deducted before he has taxable income. If the statute were construed otherwise, it would unconstitutionally tax "income" where there is no income or profit.

If the Congress of the United States intended to levy an income tax against citizens of the District of Columbia in situations of the kind at bar, a construction to be avoided if at all possible, then the act which purports to levy the tax is unconstitutional, contrary to the

provisions of the Fifth Amendment, in that a tax is to be measured by the accumulated income of a corporation in liquidation, rather than by the income of the stockholder distributee. Further, it would be unconstitutional, in violation of the Fifth Amendment, to levy a tax when no income or gain or profit were realized, by the use of an artificial standard that sets up a conclusive presumption against the facts of the case. This is true because income taxes are to be levied only upon income received or gain or profit realized.

If, on the other hand, the tax law should be construed as taxing a portion of the distribution as a dividend in these circumstances, the same amount cannot also be deemed a return of the petitioner's capital investment. Since the aggregate value of what he received was no greater than his cost, he sustained a loss of capital to the extent that the distribution is taxed as a dividend. That offsetting loss is deductible under the District statute. The liquidation was no less a closed transaction, realizing gain or loss, merely because the distribution was made in property rather than entirely in cash.

The Tax Court erroneously limited the petitoner's basis for the building, received in the liquidation, to an allocable portion of the corporate capital and surplus. A "reasonable allowance" for depreciation should be based upon the taxpayer's own cost incurred in acquiring the assets, not the cost incurred by, or the original investment in, and accumulated earnings of, a third party. Even if it were proper to apply a transferred basis to the property, it would be more appropriate to use an allocable part of the petitioner's cost of the stock, rather than a figure that has no relation whatever to his investment.

ARGUMENT

I.

The Transaction Was in Substance a Purchase of Assets, Resulting in No Gain to the Purchaser, and Entitling Him to a Basis Equal to His Cost

There is one fundamental principle that governs the issues in both these consolidated cases, and which distinguishes all the decisions relied upon by the Tax Court. That principle is that a purchase of all the stock of a corporation, for the express purpose of obtaining its assets through immediate liquidation, is in substance a purchase of the assets themselves. As has been shown, petitioner made settlement of his Contract which contemplated his purchase of an apartment house known as the Lombardy, by buying all of the shares of the stock of the corporation on January 7, 1960, liquidating the corporation the same day, and obtaining a deed to the corporate property at the same time. His obvious intention was to buy the apartment house and, in fact, he did so. He dealt at arms length with the seller, receiving on the sale assets the fair market value of which were not in excess of his cost (JA 17). Thus, he realized no income or gain or profit.

Ordinarily, in the absence of unusual circumstances not here present, an arm's length purchase of assets gives rise to no taxable income at the time of purchase. See *Commissioner v. Lo Bue*, 351 U.S. 243, 248 (1956). Therefore, it is well established in federal tax cases that one who purchases all the stock of a corporation, in order to obtain its assets through liquidation, realizes no taxable gain or deductible loss upon the distribution in liquidation, even if (as is not the case here) the value of the assets received differs from the cost of the stock. *Commissioner v. Ashland Oil & Refining Co.*, 99 F.2d 588, 591 (6th Cir. 1938); *United States v. Mattison*, 273 F.2d 13 (9th

Cir. 1959); *Ruth M. Cullen*, 14 T.C. 368 (1950); *H. B. Snively*, 19 T.C. 850 (1953), aff'd on other issue, 219 F.2d 266 (5th Cir. 1955). Those decisions declined to apply literally the federal statutory provisions relating to the taxability of liquidating distributions because the substance of the transaction in each case was that the purchaser received, not a liquidating distribution, but the underlying assets which he had, in effect, purchased.

The same basic principle governs the determination of the basis of the property acquired. It is well settled under the federal tax law that, in circumstances like the present, the statutory provisions governing basis of property received in liquidation are not applicable, and basis is to be determined as if the taxpayer had bought the property itself. *Kimbell-Diamond Milling Co.*, 14 T.C. 74, 80 (1950), *aff'd per curiam*, 187 F.2d 718 (5th Cir. 1951); *United States v. M. O. J. Corp.*, 274 F.2d 713 (5th Cir. 1960); Rev. Rul. 60-246, 1960-2 C.B. 462. In *Estate of James F. Suter*, 29 T.C. 244, 257-260 (1957), that principle was applied to a purchase by an individual.

The Tax Court, nevertheless, refused to apply that principle under District law, holding that, since petitioner had become the sole stockholder of Lombardy, Inc. at the time of its liquidation, "He made his bed and must lie in it." (JA 37, 41-42) None of the cases (hereafter discussed) by which the Tax Court felt bound, and no other prior decisions of the Tax Court or of this Court, have, however, dealt with a situation like this, in which the taxpayer bought stock solely in order to acquire assets by liquidation. There is no more reason to exalt form over substance in applying the District tax law than there was in the federal tax cases above cited. Therefore, irrespective of the effect which the District tax provisions relating to liquidating distributions might have in different circumstances, they are irrelevant in this fact situation.

Accordingly, in Docket No. 19232, no tax should have been imposed upon petitioner's receipt of the property which had, in substance, been purchased by him. In Docket No. 19233, the price which petitioner paid for the stock (apportioned among the assets) should be allowed as the basis for the property he thereby acquired.

If the foregoing principle is accepted, this Court need go no further. However, because the Tax Court rejected that basic principle and relied upon a misconstruction of the statutory provisions relating to corporate liquidations, those provisions will be discussed in the remaining portions of this Brief.

II.

There Can Be No Taxable Income Derived From a "Dividend" in Complete Liquidation Where the Taxpayer Receives No More Than His Cost

A. The Berliner Case Taxed No More Than the Taxpayer's Profit on the Liquidation.

The Tax Court, refusing to be guided by the substance of the transaction, reached the remarkable conclusion that the taxpayer had derived $324,318.88 in "dividend" income from a transaction in which the petitioner obtained assets worth no more than his capital outlay. The Tax Court reasoned that the portion of the distribution representing earned surplus of the corporation was a dividend within the definition of Sec. 47-1551c(m) which provides in pertinent part:

> "(m) The word 'dividend' means any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits, or surplus (other than paid-in surplus), whenever earned by the corporation and whether made in cash or any other

> property . . . and whether distributed prior to, during, upon or after liquidation or dissolution of the corporation: . . ." (Emphasis added)

The court considered that the "plain language" of the statute, and this Court's decision in *Berliner v. District of Columbia*, 103 U.S. App. D.C. 351, 258 F.2d 651 (1958), *cert. denied*, 357 U.S. 937 (1958), required the imposition of dividend tax on an amount equal to the earned surplus of the corporation, despite the fact that the petitioner had not recovered, and could not ever recover from the stock, any amount in excess of his cost.

Petitioner is not attempting to relitigate the issue disposed of in *Berliner v. District of Columbia, supra.* Petitioner would agree that, if he realized any income from the transaction, it would be taxable as a dividend and could not be exempt as capital gain (even apart from the fact that, unlike *Berliner*, petitioner had less than a two-year holding period so the stock was not a capital asset).

The issues here raised, however, were not present in *Berliner*, because that taxpayer was an original stockholder, whose stock cost was no greater than the paid-in capital of the corporation, which was excluded from dividend treatment. The opinion leaves no doubt that the issue was considered by this Court in that context. Thus, the Court stated the issue to be:

> ". . . whether amounts distributed in complete liquidation of a corporation, to the extent that those amounts exceed the cost of the stock and represent corporate earnings, are properly includible in the stockholders' gross income as a dividend under Section 47-1551c(m) of the District of Columbia Code (1951)." (Emphasis added)[2]

[2] 103 U.S. App. D.C. at 352, 258 F.2d at 652. Judge Danaher, dissenting on another ground, stated: "I am confident my colleagues will not wish to be understood as saying that a 'dividend', as they define it, will result in tax-

(*continued on following page*)

In holding that treating the distribution of earnings in liquidation as a dividend did not violate the due process clause of the Constitution, the Court of Appeals declared that the taxpayer's argument —

> ". . . overlooks the fact that the distributions not only returned to them their capital investments in full but also a substantial additional amount as a gain or profit. The question is whether the Fifth Amendment permits Congress to tax this profit as dividend income, when it also represented a distribution of corporate earnings. The courts have frequently recognized that a distribution of earnings in liquidation may rationally be treated as a dividend as well as an exchange. [Footnote omitted.] It was constitutionally open to Congress to elect to tax the profit as a dividend for purposes of the District tax, just as it was constitutional for it to do so for purposes of the 1921 Federal Act." (Emphasis added)[3]

The *Berliner* decision clearly is not authority that the imposition of dividend tax on one who had not recovered his cost in liquidation is either required by the statute or permitted by the Constitution.

B. The D.C. Statute Taxes a "Dividend" in Liquidation Only If "Income" Is Derived Therefrom.

Although Sec. 47-1551c(m) concededly defines "dividend" in terms broad enough to embrace a distribution of corporate earnings in liquidation without reference to whether the recipient recovers his cost,

(*Footnote 2 continued from preceding page*)
ability as though upon income if the stockholder takes a loss when a corporation upon liquidation returns less than his invested capital. The point is arguable, nevertheless. I read the majority opinion as intended to deal only with the distribution of amounts which 'exceed the cost of the stock and represent corporate earnings.'" 103 U.S. App. D.C. at 359, n.9; 258 F.2d at 659, n.9.

[3] 103 U.S. App. D. C. at 355-356, 258 F.2d at 655-656.

that is not the provision under which dividends are taxed. The governing provision is Sec. 47-1557a(a), which defines gross income as —

> ". . . gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, . . . or income derived from any trade or business or sales or dealings in property, whether real or personal, other than capital assets as defined in this subchapter, growing out of the ownership, or sale of, or interest in, such property; also from rent, royalties, interest, dividends, securities, or transactions of any trade or business carried on for gain or profit, or gains or profits, and income derived from any source whatever." (Emphasis added)

The words used in describing "gross income" are many, and the syntax is involved, but it is abundantly clear from the relationship of the italicized words that Congress intended that dividends (as defined in Sec. 47-1551c(m) be included in gross income (and hence in taxable or net income)[4] only if the taxpayer derives income from such dividends. That view is sustained by the very federal tax case from which the Tax Court drew the contrary conclusion (JA 37). *United States v. Phellis*, 257 U.S. 156, 168-169 (1921).

The *Phellis* case involved §2B of the Revenue Act of 1913, 38 Stat. 114, 167, the language of which is strikingly similar to the District law. Under the federal Act, net income was defined to include —

> ". . . gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form

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[4] The tax is imposed "upon the taxable income of every resident." Sec. 47-1567 b(a). The "taxable income" means the "entire net income", less certain exemptions and credits. *Id.* Sec. 47-1567. The "net income" means the "gross income" less deductions. *Id.* Sec. 47-1557. For present purposes, therefore, the definition of "gross income" is controlling.

> paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rents, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, . . ." (Emphasis added)

The Court declared (p. 169), "Disregarding the slight looseness of construction, we interpret 'gains, profits, and income derived from . . . dividends,' etc., as meaning not that everything in the form of a dividend must be treated as income, but that income derived in the way of dividends shall be taxed." (Emphasis by the Court).

The Tax Court (JA 35-36) sought to draw a distinction in that "income derived from . . . dividends" is subject to District tax, whereas "gains, profits, and income derived from . . . dividends" were taxed under the federal law construed in *Phellis*. The Tax Court's view was that a dividend may be "income" even though it involves no "gain or profit." It is evident, however, that the Supreme Court regards the terms "income" and "gain" as interchangeable, since it has often defined "income" as "the gain derived from capital, from labor, or from both combined." *Goodrich v. Edwards*, 255 U.S. 527, 535 (1921); *Eisner v. Macomber*, 252 U.S. 189, 207 (1920). With specific reference to the view, here reiterated by the Tax Court, that there may be "gross income" where there is no gain, the Supreme Court said in *Southern Pacific Co. v. Lowe*, 247 U.S. 330, 335 (1918):

> "We must reject . . . the broad contention submitted in behalf of the government that all receipts — everything that comes in -- are income within the proper definition of the term 'gross income,' and that the entire proceeds of a conversion of capital assets, in whatever form and under whatever circumstances accomplished, should be treated as gross income."

Whether the terms used in the statute be "gains and profits" or "income," it is clear, both as a matter of statutory construction and of constitutional law, that there can be no "gross income" unless provision is made for tax-free recovery of cost out of gross receipts. *Burnet v. Logan*, 283 U.S. 404, 413 (1931); *Commissioner v. Weisman*, 197 F.2d 221, 223 (1st Cir. 1952); *Lela Sullenger*, 11 T.C. 1076 (1948). Furthermore, if anything, the federal Act construed in the *Phellis* case was broader, not narrower, than the District law, since the former embraced, in addition to gains and profits from dividends, the "income" from dividends to which alone the District law applies.

C. The D.C. Statute Should Be Construed To Reach a Reasonable Result in Harmony With the Congressional Purpose To Tax Net Income.

Even if the literal meaning of the District statute seemed to compel the taxation of income where there is no gain (as the Tax Court held), that meaning would not necessarily control. The Supreme Court declared in *United States v. Kirby*, 74 U. S. (7 Wall.) 482, 486, 19 L. Ed. 278, 280 (1869):

> "All laws should receive a sensible construction. General terms should be so limited in their application as not to lead to injustice, oppression, or an absurd consequence. It will always, therefore, be presumed that the legislature intended exceptions to its language, which would avoid results of this character. The reason of the law in such cases should prevail over its letter." (Emphasis added)

Again, in *United States v. American Trucking Ass'ns*, 310 U.S. 534, 543 (1940), the Supreme Court said:

> "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes. Often these words are

> sufficient in and of themselves to determine the purpose of the legislation. In such cases we have followed the plain meaning. When that meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words." (Emphasis added; footnotes omitted)

It is unnecessary to multiply authorities for that proposition, which this Court has frequently applied, most recently in *Shaffer v. Singh*, No. 18616, decided February 11, 1965. See also *Manoukian v. Tomasian*, 99 U.S. App. D. C. 57, 59-60, 237 F.2d 211, 213-214 (1956); and in tax cases, *Hyman v. District of Columbia*, 101 U.S. App. D.C. 179, 181, 247 F.2d 585, 587 (1957); *Leon Turnipseed*, 27 T.C. 758 (1957); *Robert S. Bassett*, 26 T.C. 619 (1956).

A particularly pertinent application of that principle is found in *Goodrich v. Edwards*, 255 U.S. 527 (1921), which involved §2(c) of the Federal Revenue Act of 1916, 39 Stat. 756, which prescribed that the basis for determining gain derived from the sale or other disposition of property acquired before March 1, 1913 should be the value of the property on that date. The taxpayer had acquired corporate stock in 1912 at a cost of approximately $300,000.00, which had decreased in value to approximately $150,000.00 by March 1, 1913. The stock was sold in 1916 for approximately $270,000.00, resulting in an actual loss of some $30,000.00 of the taxpayer's investment. The district court, applying the statute literally, sustained the Collector of Internal Revenue in taxing a gain of approximately $120,000.00. The Supreme Court, agreeing with a confession of error by the Government, stressed the general purpose of the statute, stating (255 U.S. at 535):

> "It is thus very plain that the statute imposes the income tax on the proceeds of the sale of personal property to the extent only that gains are derived therefrom by the vendor; and we therefore agree with the Solicitor General that since no gain was realized on this investment by the plaintiff in error, no tax should have been assessed against him."

To the same effect is *Walsh v. Brewster*, 255 U.S. 536 (1921).

The clearly declared purpose of the present statute is to impose "an income tax upon the entire net income of every resident . . ." Sec. 47-1580 (Emphasis added.) It was not intended to impose a capital levy. It is incumbent upon this Court, therefore, to construe Sec. 47-1551c(m), in conjunction with Sec. 47-1557a(a), *supra*, in harmony with that legislative purpose, which should preclude taxing as a "dividend" the receipt in final liquidation of corporate assets which no more than return the taxpayer's cost. Such construction would not only avoid an absurd and inequitable result, but would also avoid grave doubts of constitutionality. *Crowell v. Benson*, 285 U.S. 22, 62 (1932); *International Association of Machinists v. Street*, 367 U.S. 740, 747 (1961).

D. Unlike a Distribution by a Going Concern, a Final Distribution in Liquidation May Not Constitutionally Be Taxed as Income Unless the Taxpayer Has Recovered His Cost Tax-Free.

The fact that income had previously been realized by a corporate entity, Lombardy, Inc., with which the petitioner later had a transitory connection, is not a sufficient constitutional basis for taxing him on a distribution which returns to him no more than his cost. The corporate income was not his income, and could not be made such, as a constitutional matter, by labeling it as income, even if the statute had purported so to label it. As the Supreme Court said in *Hoeper v. Tax Commission*, 284 U.S. 206, 215 (1931):

> "We have no doubt that, because of the fundamental conceptions which underlie our system, any attempt by a state to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the 14th Amendment. That which is not in fact the taxpayer's income cannot be made such by calling it income."

The due process clause of the Fifth Amendment imposes the same restraints upon Congress, in legislating for the District, which the Fourteenth Amendment imposes upon a state legislature. *Bolling v. Sharpe*, 347 U.S. 497, 499 (1954); *Hamilton National Bank v. District of Columbia*, 85 U.S. App. D.C. 109, 176 F.2d 624 (1949), *cert. denied*, 338 U.S. 891 (1949).

To hold that a distributee of corporate earned surplus is deemed to have realized income, irrespective of whether the distributee himself realized any gain or profit over his cost, is to indulge in a presumption contrary to fact. Such an arbitrary conclusive presumption, contrary to fact, violates the due process clause of the Fifth Amendment. *Heiner v. Donnan*, 285 U.S. 312 (1932). It was held in that case that it is unconstitutional for Congress to lay down an arbitrary and capricious rule prohibiting proof that gifts made by a decedent within two years prior to his death were in truth and in fact not made in contemplation of death. It would be an equally aribitrary and capricious use of the taxing power if Congress were to lay down a rule that property received upon liquidation of a corporation is income to the extent of the earned surplus of the corporation, when in truth, and in fact the recipient of the corporate assets recovered only his cost and did not receive income or realize a gain or profit.[5]

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[5] The Tax Court (JA 38) noted the constitutional issue but, "in accordance with its custom, prompted by the unsettled matter of the Court's status," refrained from passing on the question.

It is, of course, true, and has not been doubted since the *Phellis* case, *supra,* that a distribution of earnings by a going corporation may be taxed as a dividend without regard to whether the stockholder has recovered the cost of his stock. The *Phellis* case involved a transfer of a major part of a corporation's assets to a newly-formed corporation and a distribution of stock thereof to the stockholders of the old corporation. The old corporation continued as a going concern, although with limited assets. The basic issue in the case was whether the division of the taxpayer's investment into stock of two corporations, worth in the aggregate no more than the stock of one had been worth immediately before the transaction, was an income-realizing event. In the course of discussion, however, the Court addressed itself to the taxpayer's hypothetical argument that one who happened to buy stock shortly before the distribution would suffer "apparent hardship" because the dividend, on which tax was imposed, in effect impaired the value he had paid for. The Court declared that, even in such a case, the severance of corporate profits was subject to dividend tax (257 U.S. at 171).

A distribution by a going concern differs from one in liquidation, however, in that the stockholders continue to maintain their proportionate interests in the corporation. The cost of their stock is irrelevant to the taxability of the distribution of corporate profits, since there has been no closed transaction with respect to the stock and it remains entirely conjectural whether the stockholders will ultimately realize a loss on the stock as a result of the depletion of corporate assets by the dividend payment. Although any such dividend diminishes the assets of the corporation, "it demonstrates the capacity of the corporation to pay dividends, holds out a promise of further dividends in the future, and quite probably increases the market value of the shares." *Lynch v. Hornby,* 247 U. S. 339, 346 (1918).

In contrast, a dividend paid to stockholders in conjunction with complete liquidation of the corporation finally closes the transaction

with respect to their stock. Irrespective of whether the stockholders surrender the pieces of paper representing their stock interests, the final distribution drains the stock of any value and precludes their ever recovering any more of their cost than they have received in such liquidation. In such a case, unlike the situation in *Phellis,* the taxpayer's cost for the stock is highly relevant to the question whether he has realized "gross income" from the dividend.

The Court in *Phellis* was plainly conscious of this distinction, for it stressed the fact that the distributing corporation "continued as a going concern" and "is not, however, in process of liquidation" (257 U.S. at 167), and its conclusion was carefully limited to relate it to distributions "not in liquidation of the capital" (p. 175). The precedent value of the *Phellis* decision for present purposes, therefore, lies not in the decision on the particular facts (which are quite different), but in the clear statement of principle that it is not a dividend, as such, that is taxable, but income derived in the way of dividends.

E. The Regulations Under the Federal Revenue Act of 1921 Support Petitioner's Position.

In *Berliner v. District of Columbia, supra,* 103 U. S. App. D. C. at 354, 258 F.2d at 654, this Court regarded as "especially significant" the federal precedents under the Revenue Act of 1921, 42 Stat. 227, because of its close parallel to the present District statute. Like the 1913 Act involved in *Phellis, supra,* the 1921 Act defined "gross income" as including "gains, profits and income derived from . . . dividends . . ." (§213(a)), which, as above discussed, is very similar to Sec. 47-1557a(a) of the D. C. Code. The 1921 Act (§201(a)) defined a "dividend" to mean "any distribution made by a corporation to its shareholders or members . . . out of its earnings or profits . . ." Because §201 did not contain the special provision found in the 1918 Act and in subsequent Acts, treating liquidating distributions as proceeds

of an exchange of stock, the words "any distribution" were construed to embrace liquidating distributions — a matter which is expressly provided for in Sec. 47-1551c(m) of the D. C. Code.

Construing the Revenue Act of 1921, the Treasury Regulations made clear that a stockholder who received a distribution in complete liquidation was entitled to recover his stock cost tax-free before any amount was taxable as a dividend. It was provided in Article 1545 of Treasury Regulations 62 (1922 ed.):

> "ART. 1545. Distributions in liquidation. --Where a corporation distributes all its property in complete liquidation or dissolution, the gain realized by the stockholder from the transaction, computed under section 202, is taxable as a dividend to the extent that it is paid out of earnings or profits of the corporation accumulated since February 28, 1913. If the amount received by the stockholder in liquidation is less than the cost or other basis of the stock, a deductible loss is sustained." (Emphasis added)

Applying those principles, the Commissioner of Internal Revenue, in Mim. 3155, III-1 Cum. Bull. 29, 30 (1924), directed that, where a distribution in liquidation is paid to a shareholder, "it is necessary first to determine whether a gain or loss has been realized by such shareholder, using the tax basis prescribed in section 202 of the Act."[6] Only when, and to the extent that, a gain was realized was any dividend tax imposed. If the gain was less than the shareholder's pro rata part of the corporate earnings, dividend tax was applied only to his gain; if he had no gain, no dividend tax was incurred. The examples in Mim.

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[6] Like Sec. 47-1583, D. C. Code, §202 of the 1921 Act prescribed the basis for determining gain or loss from a "sale or other disposition" of property. While District law says "sale, exchange or other disposition", this Court held in *Berliner* that a liquidation is not an "exchange" under District law, and it was not treated as such under the 1921 Act. For present purposes, therefore, the provisions are parallel.

3155 leave no doubt of this. See also Magill, *Income Tax Liability of Dividends in Liquidation,* 23 Mich. L. Rev. 565 (1925), characterizing such rule as "eminently reasonable."

F. The Tax Court's *Dinkin, Uline,* *Goldstein* Cases Were Wrongly Decided and, in Any Event, Are Distinguishable.

In addition to the *Berliner* and *Phellis* cases, which do not support the decision below, the Tax Court relied upon two of its own decisions.[7] In one of them, *Max Dinkin v. District of Columbia,* 89 Wash. L. Rep. 1293 (July 7, 1961), the Tax Court misconstrued *Berliner,* as it did in the present case, to require that corporate earnings distributed in complete liquidation must be taxed to the stockholder as a dividend even though, as a result, he is denied a tax-free recovery of his own capital investment. The *Dinkin* case was not appealed. The other such case was *Estate of M. J. Uline v. District of Columbia,* 91 Wash. L. Rep. 1863 (Sept. 30, 1963), which taxed earnings distributed in liquidation without permitting the estate to recover tax-free from the distribution the stepped-up basis of the stock established as of the date of death of the original stockholder. The *Uline* case is pending on appeal to this Court, Docket No. 18,256. A similar case, not cited, is *Harry D. Goldstein v. District of Columbia,* 91 Wash. L. Rep. 3083 (November 15, 1963), which is also pending in this Court, Docket No. 18,488.

We believe, for reasons already detailed, that the *Dinkin, Uline* and *Goldstein* decisions were wrongly decided by the Tax Court. If, in the pending appeals of *Uline* and *Goldstein,* this Court should disagree with our view, the cases are nevertheless distinguishable since

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[7] It also cited *Rafferty v. Comptroller of the Treasury*, 228 Md. 153, 178 A.2d 896 (1962), which reached a similar result under Maryland law. It is of interest that the Maryland legislature reacted promptly by overturning the rule of that decision by Laws of 1964, ch. 87, amending Md. Ann. Code (1957) §279(j).

they involve denial of a stepped-up basis at death, not (as in *Dinkin* and the present case) a tax on the return of the taxpayer's own capital outlay. Perhaps Congress might constitutionally deny an estate the right to recover a stepped-up basis out of a liquidating distribution, since the step-up involves no capital investment beyond the decedent's original capital outlay (which was allowed tax-free). *Cf. Taft v. Bowers,* 278 U.S. 470, 482 (1929). But it does not follow therefrom that a purchaser of stock may be taxed on such a distribution, without provision for recovery of his own capital outlay. See discussion at pages 15-25, inclusive, *supra.*

The *Dinkin, Uline* and *Goldstein* cases are also distinguishable because none of them involved a taxpayer who, like this petitioner, purchased the stock simply for the purpose of obtaining the underlying assets, and promptly liquidated the corporation. See Part 1, *supra.*

III.

If a Portion of the Liquidating Distribution Is Taxed as a Dividend, Petitioner Is Entitled To Deduct a Loss of Equal Amount on Account of His Unrecovered Cost.

A. Decisions Under the Federal Revenue Act of 1921 Sustain Such a Loss Deduction.

If, nevertheless, this Court should be of the opinion that the statute requires imposition of a dividend tax to the full extent of the corporate earned surplus distributed in liquidation, the tax deficiency still cannot be sustained because the petitioner is entitled under the statute to an offsetting loss deduction. The aggregate value of the assets distributed to petitioner in liquidation was no greater than the amount of his capital investment of about $1,000,000.00 (JA 17). If $324,318.88 of the distribution was a dividend (JA 8, 35), not over $675,681.12 thereof could be a return of capital. The latter figure

falls short by $324,318.88 of returning the petitioner's capital investment, and he thus suffered a loss equal to the amount (if any) treated as a dividend.

This was the approach adopted by the courts under the federal Revenue Act of 1921, heretofore discussed (pp. 25-27). Instead of limiting the taxable dividend to the amount of the taxpayer's gain, as prescribed in Article 1545 of Treasury Regulations 62 and Mim. 3155, *supra* (p. 26), the courts held that the stockholder's proportionate share of the corporate earnings was a dividend to its full extent, but that gain or loss should then be computed on the transaction, using the net distribution (after deducting the amount taxed as a dividend) as the proceeds realized from the stock. *Eric A. Pearson*, 16 B.T.A. 1405 (1929); *Haystone Securities Corp.*, 19 B.T.A. 954 (1930); *Hamilton Woolen Co.*, 21 B.T.A. 334 (1930). Approving that principle, the Second Circuit Court of Appeals said in *Commissioner v. Sansome*, 60 F.2d 931, 932 (2d Cir. 1932):

> ". . . only distributions not allocated to profits by subdivision b [of §201 of the 1921 Act] may be used to reduce the subtrahend for computing the gain derived, or the loss sustained. This means that the shareholder is to be taxed upon the dividends as such so far as they represent profits, calculated under the preceding subdivision and that <u>what is left shall be treated as amortizing his cost</u>. The rule would work in some cases to the taxpayer's advantage and in others not; he escapes normal taxes pro tanto [since dividends were not subject to normal tax], provided he has enough income in later years [when the liquidation was completed] to use as a deduction the loss calculated upon the reduced payment . . .
>
> ". . . The taxpayer gets his quid pro quo in the closing transaction. Though it is a chance

> whether the final resultant will be favorable or not, the dice are not loaded against him." (Bracketed material and emphasis added)

The practical difference between the approach under Part 2 (limiting the taxable dividend to the gain) and the approach taken in those federal decisions may be illustrated by a simple example. Suppose a stockholder pays $100 for stock, and later receives $105 as a distribution in complete liquidation, of which $75 represents corporate earnings. The Part 2 approach, which was followed by the Treasury under the 1921 Act, would net the whole transaction, computing a gain of $5 and taxing only that amount as a dividend. The above decisions, on the other hand, would tax $75 at the rates applicable to dividends, and would treat the remaining $30 of the distribution as a recovery of cost, resulting in a capital loss of $70.

B. The Loss Allowable Under Federal Decisions Is Also Allowable Under D.C. Law, Since the Stock Was Held Less Than Two Years.

It cannot be argued that the loss here sustained by petitioner is not allowable to him under District law. Sec. 47-1557b(b)(6) denies deduction of capital losses (from the sale or exchange of assets held for more than two years) but does not restrict deduction of losses on assets held for two years or less.[8] In the *Uline, Goldstein* and *Dinkin* cases, this alternative claim for an offsetting loss deduction was not open to the taxpayers, since those who had a basis in excess of their share of the paid-in capital had all acquired their stock more than

[8] "Capital assets" are defined in Sec. 47-1551c(1), D.C. Income and Franchise Tax Act of 1947, Article I, Title I, §4(1), 61 Stat. 332, as assets held for more than two years.

two years before the liquidation, and the stock was a capital asset in their hands.[9]

Subject to the exception for capital losses (here inapplicable), Sec. 47-1557b(a)(4)(B) allows in sweeping terms a deduction for losses sustained ". . . if incurred in any transaction entered into for the production or collection of income subject to tax under this subchapter . . ." Such a loss is "sustained" when there has been a transaction which finally establishes that the taxpayer has lost all or part of his capital. *Cf. Lucas v. American Code Co.*, 280 U.S. 445, 449 (1930). Upon the completion of the liquidation of Lombardy, Inc., it was conclusively established that petitioner could never recover another dollar on the stock, and a loss was "sustained" to the extent that the amount of the distribution allocable to return of capital fell short of the amount the petitioner had invested.

It is irrelevant for this purpose that District law (as held in *Berliner v. District of Columbia, supra*, 103 U. S. App. D. C. at 354-355, 258 F.2d at 654-655) does not treat a liquidation as a "sale or exchange." Sec. 47-1557b(a)(4)(B) does not restrict allowable losses to those sustained on sales or exchanges.

C. A Liquidation in Kind Is a Closed Transaction Realizing Gain or Loss.

There is no basis in the statute or otherwise for regarding the liquidation as other than a closed transaction merely because the petitioner received property, rather than cash alone. Certainly the statute regards a distribution of property in liquidation as a closed transaction to the extent that it is taxed as a dividend [Sec. 47-1551c(m)], and there is nothing in the statute which would treat the receipt of the

[9] Similarly, the argument was not available in the Maryland case of *Rafferty v. Comptroller of the Treasury*, *supra*, because Maryland law does not allow deduction of capital losses, regardless of holding period. Md. Ann. Code (1957) Art. 81, §283(a).

remaining (return-of-capital) portion of the distribution as other than a closed transaction. *Cf. Osenbach v. Commissioner*, 198 F.2d 235 (4th Cir. 1952). Ordinarily a closed transaction would be negatived only if there were some express provision making the liquidation tax-free and specifying that the property received shall stand in the place of the stock, for basis and other purposes. Whatever the rule might be if the stock were a capital asset, the gain or loss on which is not recognized by District law (except to the extent of the dividend element), the stock held by petitioner was not a capital asset and no non-recognition provision was applicable to the liquidation.[10] If the petitioner had realized a gain on the receipt of property in liquidation of stock which was not a capital asset, it cannot be supposed that he would not have been taxed thereon. There is no better ground for denying deduction of a loss.

Here again, the *Sansome, Pearson, Haystone* and *Hamilton* cases (p. 29, *supra)*, which allowed losses upon liquidations under the Federal Revenue Act of 1921, are applicable. That Act, like the District statute, did not treat a liquidation as a sale or exchange; but that fact did not preclude treating the liquidations as closed transactions realizing losses. The *Hamilton Woolen Co.* case is a particularly close parallel to this case, because that taxpayer bought stock and immediately liquidated the corporation, receiving a plant and other property in addition to cash. The distribution was taxed as a dividend to the extent of earnings, and a loss was allowed to the extent that the value of the remaining portion of the distribution failed to return the

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[10] Where the stock was a capital asset (held more than two years), the non-dividend portion of the distribution was held tax-free in *District of Columbia v. Oppenheimer*, 112 U.S. App. D.C. 239, 301 F.2d 563 (1962). But see Judge Washington's dissent in *District of Columbia v. Goldman*, 117 U.S. App. D.C. 219, 223, n.2; 328 F.2d 520, 524, n.2 (1963). The question whether the partially tax-free character of the liquidation results in a transfer of basis to the assets received is now pending before this Court in *Oppenheimer v. District of Columbia*, No. 18,639. See further discussion under Part 4, *infra*.

cost of the stock. In other cases, it was held that the basis of property received in liquidation was the market value of the property when received, thus treating the liquidation as having been a closed transaction realizing gain or loss. *Flemmon E. Gloyd,* 19 B.T.A. 966, 968 (1930), *aff'd,* 63 F.2d 649 (8th Cir. 1933), *cert. denied,* 290 U.S. 633 (1933); *George Theis, Jr.,* 3 B.T.A. 1030, 1034-1035 (1926).[11]

D. The Loss Was Sustained in a Transaction Entered into for the Production of Taxable Income

The further requirement of Sec. 47-1557b(a)(4)(B) that the loss be sustained in a transaction entered into for the production of income subject to District tax is clearly met if (as is the premise of this Part 3) the liquidating distribution included a taxable dividend. On that premise, the "transaction" was "entered into" when the petitioner purchased stock [*R. W. Hale,* 32 B.T.A. 356 (1935), *aff'd on another issue,* 66 U.S. App. D.C. 242, 85 F.2d 819 (1935); *Terry v. United States,* 10 F.Supp. 183 (D. Conn. 1934)], and was closed by the distribution in liquidation. It was entered into for the very purpose of obtaining the underlying properties by liquidation, and hence (on the premise stated) for the purpose of producing dividend income subject to District tax. The loss of petitioner's capital investment was necessarily incurred in producing the taxable dividend, and all the conditions for a loss deduction are met.

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[11] The *Gloyd* case involved the Revenue Act of 1921 and the *Theis* case the 1916 Act which, as this Court noted in *Berliner, supra,* was also like the District statute in respects here material.

IV.

The Basis for Depreciation of the Property Received in Liquidation Is Either Its Market Value When Distributed or the Cost of the Stock

A. The Liquidation Was a Closed Transaction Establishing a Basis Independent of the Corporation's Cost or Invested Capital.

The issue in Docket No. 19233 concerns the basis on which petitioner may compute depreciation on the building he obtained by the transaction in controversy. Respondent limited petitioner's basis to the corporation's $91,415.83 book value for the building (cost less past depreciation). The Tax Court determined that petitioner's basis for all the property he received was equal to the sum of the corporate earned surplus ($343,494) and its original paid-in capital ($156,585), a total of $500,079, of which it allocated $257,598.21 to the building.[12] Neither respondent's figure of $91,415.83 nor the Tax Court's figure of $257,598.21 has any relationship to petitioner's actual investment in the property or in the stock from which it was derived.

Petitioner has argued under Part 1, *supra,* that the basis of the property should be the amount paid for the stock (allocated among building, land and other assets by the same method used by the Tax Court), since the entire transaction was in substance a purchase of assets. Under this Part 4, however, we shall deal with the question of basis on the assumption that the purchase of stock and the distribution in liquidation may be viewed as separate steps.

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[12] In making the allocation, the Tax Court deducted $226,951.38 as the value of miscellaneous assets and cash received, and divided the remaining $273,127.62 in the ratio of assessed values for property tax purposes, 81.43% to the building and 18.57% to the land (JA 39-40).

The District law is silent concerning the basis of property received in liquidation (except that market value is prescribed by Sec. 47-1583c as the basis for the portion taxed as a dividend). Sec. 47-1583e provides for a cost basis in the case of property acquired by purchase, and a market value basis for property acquired by exchange; but this Court has said in *Berliner, supra,* that liquidation is not an "exchange." If this is a *casus omissus* in the statute, it becomes necessary for this Court to fill the gap, since there can be no question that Congress, by Sec. 47-1557b(a)(7) intended that a "reasonable allowance" for depreciation be deducted in these circumstances. *Connecticut Inv. Corp. v. Pearson,* 42 A.2d 685, 686 (D.C. Mun. Ct. App. 1945). Unless otherwise compelled by specific statutory mandate, it is more "reasonable" to relate the allowance for depreciation to the taxpayer's own investment, or to the market value when the property became a depreciable asset in his hands, than to relate the allowance to the investment made by (or in) a corporation to which he was a stranger until the very time of the distribution. *Connecticut Inv. Corp. v. Pearson, supra.*

As we have noted under the previous points, this Court declared in *Berliner v. District of Columbia, supra,* 103 U.S. App. D.C. at 354, 258 F.2d at 654, that precedents under the Federal Revenue Acts of 1916, 1917 and 1921 are significant because those Acts and the District statute all treated liquidating distributions as dividends to the extent of earnings. They are also alike in that they failed to specify that, if and to the extent not so taxed, the distribution is to be deemed an exchange for stock; and they also failed to prescribe expressly what the basis of property received in liquidation should be. The decisions under the federal Acts uniformly regarded the liquidation as a closed transaction establishing a new basis for the property equal to its value when distributed (without reference to how much thereof was taxed as a dividend). The courts specifically rejected the use of either the distributing corporation's cost [*Cerro de Pasco Copper Co. v.*

United States, 82 Ct. Cl. 442, 455, 13 F.Supp. 633, 639 (1936), *cert. denied*, 298 U.S. 686 (1936); *Flemmon E. Gloyd*, 19 B.T.A. 966, 968 (1930), *aff'd*, 63 F.2d 649 (8th Cir. 1933), *cert. denied*, 290 U.S. 633 (1933)] or the stockholder's cost of his stock [*George Theis, Jr.*, 3 B.T.A. 1030, 1034-1035 (1926)], as such basis.

B. The Second Oppenheimer Case Does Not Support the Decision Below.

Respondent's attempt in the court below to limit petitioner's depreciation to an amount computed on the dissolved corporation's cost thereof was claimed to be supported by the Tax Court's decision in *Beatrice W. Oppenheimer*, 92 Wash. L. Rep. 799 (April 9, 1964), which is pending on appeal to this Court, Docket No. 18,639 (hereinafter referred to as Oppenheimer No. 2). The Tax Court, in adopting a different basis equal to the sum of the capital invested in the corporation by previous owners, plus the earned surplus (the total being apportioned among the properties received), also cited that decision as its authority. It is submitted, however, that even if this Court should affirm *Oppenheimer No. 2*, it would not sustain the result reached in this case.

The taxpayer in *Oppenheimer No. 2* had been held, in an earlier case, not to be subject to dividend tax on unrealized appreciation of corporate property distributed in liquidation, even though the value of the distribution far exceeded the cost of her stock. *District of Columbia v. Oppenheimer*, 112 U.S. App. D.C. 239, 301 F.2d 563 (1962) (*Oppenheimer No. 1*). When the stockholder later sought to depreciate the property received on the basis of its value at the time of liquidation, the Tax Court excluded the previously untaxed portion of the value from such basis, relying on what it called "a cardinal principle in the logic or science of taxation that a stepped-up or change of basis is not permissible in cases of non-taxable transfer."

In contrast, the present liquidation is not claimed to be tax-free in the sense that the Oppenheimer liquidation was tax-free. Petitioner's stock, unlike Mrs. Oppenheimer's, was not a capital asset (held for more than two years). Petitioner's contention that he is free of tax on the distribution reflects only the fact that he realized no gain thereon. Accordingly, under the federal tax cases cited above, the non-tax-free liquidation should be regarded as a closed transaction, and the then value of the property should be its basis.

In any event, even if *Oppenheimer No. 2* were deemed applicable here, it should have led the Tax Court to use petitioner's stock cost as the basis of the property, rather than the corporation's invested capital and surplus. This appears to have been the actual disposition of the issue in *Oppenheimer No. 2*, although the fact is somewhat obscured because the cost of that taxpayer's stock (being original investment in the corporation) happened to be the same as the amount of the corporation's capital account. The Tax Court held that the depreciable basis for the property should include "the capital investment of the petitioner, that is to say, the portion of the paid-in surplus of the corporation pertaining to her stockholdings." (Emphasis added.) The corporation's cost for the property (net book value, used by respondent in the present case) was not referred to at all, and the corporation's "paid-in surplus" (capital account) was clearly referred to only as evidence of the investment of that taxpayer (who was an original stockholder). That figure would have no relevance in the case of the present petitioner, who was not an original stockholder and whose investment is measured by the purchase price of his stock.

Thus, even if *Oppenheimer* is affirmed, and even if it is deemed applicable at all in the circumstances of this case, it serves only to base the depreciation on petitioner's cost for his stock, which would produce the same result as basing it on the value of the distribution.

CONCLUSION

In conclusion, nothing could be more unrealistic, arbitrary, capricious or unconstitutional than to tax petitioner in the case at bar for the receipt of artificial income and at the same time to deny him a reasonable allowance for depreciation based on the cost or fair value of the assets acquired.

Accordingly, this Court should reverse the decision of the Tax Court and order a refund to petitioner of the taxes paid based on a recomputation to be made in the light of the principles presented.

Respectfully submitted,

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APPENDIX

STATUTES

Federal Revenue Act of 1921, Section 201(a):

That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922. (Federal Revenue Act of 1921, 42 Stat. 227)

Federal Revenue Act of 1921, Section 213(a):

Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income" —

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross

income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; (Federal Revenue Act of 1921, 42 Stat. 227)

D. C. Code (1961 Ed.), Section 47-1551c(1):

(1) The words "capital assets" mean any property, whether real or personal, tangible or intangible, held by the taxpayer for more than two years (whether or not connected with his trade or business), but do not include stock in trade of the taxpayer, or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the end of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. (July 16, 1947, 61 Stat. 332, Art. I, title I, § 4; May 3, 1948, 62 Stat. 206, ch. 246, § 1; May 27, 1949, 63 Stat. 129, ch. 146, title IV, §§ 401, 402; Mar. 31, 1956, 70 Stat. 68, ch. 154, § 2.)

D. C. Code (1961 Ed.), Section 47-1551c(m):

(m) The word "dividend" means any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits, or surplus (other than paid-in surplus), whenever earned by the corporation and whether made in cash or any other property (other than stock of the same class in the corporation if the recipient of such stock dividend has neither received nor exercised an option to receive such dividend in cash or in property other than stock instead of stock) and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation: Provided, however, That in the case of any dividend which is distributed other than in cash or stock in the same class in the corporation and not exempted from tax under this subchapter, the basis of tax to the recipient thereof shall be the market value of such property at the time of such distribution: And provided, however, That the word "dividend" shall not include any dividend paid by a mutual life insurance company to its shareholders. (July 16, 1947,

61 Stat. 332, Art. I, title I, § 4; May 3, 1948, 62 Stat. 206, ch. 246, § 1; May 27, 1949, 63 Stat. 129, ch. 146, title IV, §§ 401, 402; Mar. 31, 1956, 70 Stat. 68, ch. 154, § 2.)

D. C. Code (1961 Ed.), Section 47-1557a(a):
Gross income and exclusions therefrom.

(a) The words "gross income" include gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, including salaries, wages, and compensation paid by the United States to its officers and employees to the extent the same is not exempt under this subchapter, or income derived from any trade or business or sales or dealings in property, whether real or personal, other than capital assets as defined in this subchapter, growing out of the ownership, or sale of, or interest in, such property; also, from rent, royalties, interest, dividends, securities, or transactions of any trade or business carried on for gain or profit, or gains or profits, and income derived from any source whatever. (July 16, 1947, 61 Stat. 335, Art. I, title III, § 2; May 3, 1948, 62 Stat. 207, ch. 246, § 3; May 27, 1949, 63 Stat. 130, ch. 146, title IV, §§ 403, 420; Sept. 4, 1957, 71 Stat. 605, Pub. L. 85-281, §§ 1, 3; June 27, 1960, 74 Stat. 219, Pub. L. 86-522, § 1.)

D. C. Code (1961 Ed.), Section 47-1557b(a)(4)(B):
Deductions

(a) Deductions allowed—The following deductions shall be allowed from gross income in computing net income:

* * *

(4) Losses.—Losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * *

(B) if incurred in any transaction entered into for the production or collection of income subject to tax under this subchapter, or for the management, conservation, or maintenance of property held for the production of income subject to tax under this subchapter, though not connected with any trade or business; (July 16, 1947, 61 Stat. 337, ch. 258, Art. I, title III, § 3; May 27, 1949, 63 Stat. 130, ch. 146, title IV, §§ 404-409; Mar. 31, 1956, 70 Stat. 69, ch. 154, §§ 3, 4; Sept. 4, 1957, 71 Stat. 606, Pub. L. 85-281, § 4.)

D.C. Code (1961 Ed.), Section 47-1557b(a)(7):
Deductions

(a) Deductions allowed—The following deductions shall be allowed from gross income in computing net income:

* * *

(7) Depreciation.—A reasonable allowance for exhaustion, wear, and tear of property used in the trade or business, including a reasonable allowance for obsolescence; and including in the case of natural resources allowances for depletion as permitted by reasonable rules and regulations which the Commissioners are hereby authorized to promulgate. The basis upon which such allowances are to be computed is the basis provided for in section 47-1583e. (July 16, 1947, 61 Stat. 337, ch. 258, Art. I, title III, § 3; May 27, 1949, 63 Stat. 130, ch. 146, title IV, §§ 404-409; Mar. 31, 1956, 70 Stat. 69, ch. 154, §§ 3, 4; Sept. 4, 1957, 71 Stat. 606, Pub. L. 85-281, § 4.)

D.C. Code (1961 Ed.), Section 47-1557b(b)(6):

(b) Deductions not allowed.—In computing net income, no deductions shall be allowed in any case for—

* * *

(6) Capital losses.—Losses from the sale or exchange of any capital asset as defined in this subchapter. (July 16, 1947, 61 Stat. 337, ch. 258, Art. I, title III, § 3; May 27, 1949, 63 Stat. 130, ch. 146,

title IV, §§ 404-409; Mar. 31, 1956, 70 Stat. 69, ch. 154, §§ 3, 4; Sept. 4, 1957, 71 Stat. 606, Pub. L. 85-281, § 4.)

D. C. Code (1961 Ed.), Section 47-1580:
Purpose of subchapter.

It is the purpose of this subchapter to impose (1) an income tax upon the entire net income of every resident and every resident estate and trust, . . . (July 16, 1947, 61 Stat. 349, ch. 258, Art. I, title X, § 1; May 3, 1948, 62 Stat. 207, ch. 246, § 2.)

D. C. Code (1961 Ed.), Section 47-1583c:
Basis for dividends paid in property.

Where any property other than money is paid by a corporation as a dividend, the base to the recipient thereof shall be the market value of such property at the time of its distribution by such corporation. (July 16, 1947, 61 Stat. 351, ch. 258, Art. I, title XI, § 4.)

D. C. Code (1961 Ed.), Section 47-1583e:
Depreciation.

The bases used in determining the amount allowable as a deduction from gross income under the provisions of section 47-1557b(a)(7) shall be—

(a) where the property was acquired after December 31, 1938, by purchase, the basis shall be the cost thereof to the taxpayer;

(b) where the property was received in exchange for other property after December 31, 1938, the basis shall be the market value thereof at the time of such exchange;

(c) where the property was inherited or acquired by gift after December 31, 1938, the basis shall be that defined in subsection 47-1583 (b)(3);

(d) if the property was acquired prior to January 1, 1939, the appropriate basis set forth in subsection (a), (b), or (c) of this section

shall be used: Provided, however, That the taxpayer may, at his option, use as the basis the market value of such property as of January 1, 1939;

(e) the taxpayer may deduct in each taxable year only such amount of depreciation as was actually sustained during that year and such annual deduction shall be based upon the useful life of the property remaining after the date used by the taxpayer in establishing the valuation: Provided, however, That the allowance for depreciation actually sustained during any taxable year may not be increased by any depreciation of the property which was allowable as a deduction in any earlier taxable year: And provided further, That any basis so established may not be changed in a subsequent taxable year, unless written approval of the Assessor has been first obtained. (July 16, 1947, 61 Stat. 351, ch. 258, Art. I, title XI, § 6.)

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19,232

CHESTER A. SNOW,

Appellant,

v.

DISTRICT OF COLUMBIA,

Appellee.

No. 19,233

CHESTER A. SNOW, t/a
CHESTER A. SNOW RENTS,

Appellant,

v.

DISTRICT OF COLUMBIA,

Appellee.

ERRATA IN BRIEF OF APPELLANTS

Come now the Appellants in these consolidated causes by their attorneys of record, and correct the following errors in the Brief for Appellant:

1. Page 19, line 14, the word "of," following the word "way," should be underlined.

2. Page 23, line 24, the word "arbitrary" is incorrectly printed "aribitrary."

3. Page 27, line 4, the word "and" is omitted between the words "Uline" and "Goldstein."

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CERTIFICATE OF SERVICE

I hereby certify that service of the foregoing Errata in Brief of Appellants was made by mailing a copy thereof, postage prepaid, to Henry E. Wixon, Esquire, Assistant Corporation Counsel, District Building, Washington, D. C., attorney for Appellees, this 26th day of May, 1965.

Bernard I. Nordlinger

BRIEF FOR RESPONDENT

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19,232

CHESTER A. SNOW,
Petitioner,

v.

DISTRICT OF COLUMBIA,
Respondent.

No. 19,233

CHESTER A. SNOW, t/a
CHESTER A. SNOW RENTS,
Petitioner,

v.

DISTRICT OF COLUMBIA,
Respondent.

ON PETITION FOR REVIEW OF DECISIONS OF THE
DISTRICT OF COLUMBIA TAX COURT

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QUESTIONS PRESENTED

Where petitioner Chester A. Snow purchased the total outstanding stock of Lombardy, Inc. on January 7, 1960, and the corporation was completely liquidated on that day, and

Where, upon dissolution of the corporation, petitioner received all of the earnings, profits, and surplus of the company, and

Where the pertinent provisions of the District of Columbia Income and Franchise Tax Act of 1947, as amended, required, as a condition for a loss deduction, that the loss result from a transaction which was "entered into for the production or collection of income" and which was the consequence of a "sale, exchange, or other disposition of property", and

Where it has been determined by the District of Columbia Tax Court that the depreciation basis to be used on real estate received in kind by a taxpayer in complete corporate liquidation is the taxpayer's pro-rata share of the capital and paid-in and earned surplus of the liquidating corporation at the time of corporate dissolution, in the view of respondent, the questions presented are:

1. Was not the amount distributed to petitioner by Lombardy, Inc., representing its earnings, profits, and surplus, includible in petitioner's taxable gross income as a dividend?

2. Was not petitioner foreclosed from taking a loss deduction (1) where the type of transaction out of which petitioner's alleged loss arose

has previously been held by this Court not to constitute a sale or exchange and (2) where petitioner did not enter the transaction for the "production or collection of income", but for the "sole purpose" of acquiring real estate?

3. Was not petitioner incorrect in contending that the basis for depreciating the improved real property received by him upon dissolution of Lombardy, Inc. was the fair market value of that property at the time of the dissolution?

INDEX

Subject Index

CASES CITED

* Cases principally relied upon are marked by asterisks.

STATUTES CITED

MISCELLANEOUS AUTHORITIES CITED

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

CHESTER A. SNOW, Petitioner, v. DISTRICT OF COLUMBIA, Respondent.	No. 19,232
CHESTER A. SNOW, t/a CHESTER A. SNOW RENTS, Petitioner, v. DISTRICT OF COLUMBIA, Respondent.	No. 19,233

BRIEF FOR RESPONDENT

COUNTER-STATEMENT OF THE CASE

On July 17, 1959, Arthur R. Guy, the owner of the entire common stock of Lombardy, Inc., entered into a contract with petitioner by which he agreed to sell his stock to petitioner for $975,000.00 with a provision for an upward or downward price adjustment based on a formula encompassed in the agreement. (J.A. 19.)

On January 7, 1960 petitioner purchased the outstanding shares of common stock held by Arthur R. Guy for $1,029,170.88 and became the sole stockholder of Lombardy, Inc. (J.A. 28.) On the same day, the corporation was liquidated and petitioner received the assets of the corporation, including a deed for the apartment building. (J.A. 32.) The fair market value of the assets received by petitioner did not exceed the price petitioner paid Arthur R. Guy for the corporation's stock. (J.A. 17.) At the time of liquidation, the corporation's earned surplus account amounted to $324,318.88. (J.A. 8.) The capital stock of Lombardy, Inc. amounted to $156,585.00. (J.A. 16.)

No. 19,232 (Tax Court Docket No. 1934)

On March 13, 1964, a notice of assessment for a deficiency in income taxes for the year 1960 in the amount of $17,264.64, with interest thereon in the amount of $3,021.31, was served on petitioner Chester A. Snow by the District. (J.A. 5.) The assessment resulted from the determination by the District's assessing authority that the earned suplus received by petitioner upon the dissolution of Lombardy, Inc. ($324,318.88) constituted income to petitioner. (J.A. 7.) On March 16, 1964, petitioner paid the tax and interest under protest. (J.A. 5.)

No. 19,233 (Tax Court Docket No. 1935)

The second notice of assessment served on petitioner Chester A. Snow, t/a Chester A. Snow Rents, was for a deficiency in income tax for the year 1960 in the amount of $823.78, with interest in the amount of $36.66. (J.A. 47.) This assessment resulted from the determination by the District's assessing authority that the proper basis for depreciation on the apartment building acquired by petitioner upon liquidation of Lombardy, Inc., was the net book value of the assets received in liquidation, $91,415.83 (J.A. 49), rather than the alleged "cost" ($654,062.23) which petitioner allocated to the apartment building from the total purchase price of the outstanding stock of the corporation. (J.A. 38.)

Opinion and Findings of Fact in Both Cases

On February 15, 1965, the District of Columbia Tax Court filed its Findings of Fact, Opinion and Decision. In Docket No. 1934 the Tax Court sustained the District's assessment against the petitioner, as an individual, for the calendar year 1960. (J.A. 40.) In Docket No. 1935, the Court determined that the amount of the franchise tax assessed as a deficiency against petitioner as an unincorporated business was erroneous, and the petitioner was therefore entitled to a refund of the tax so paid. (J.A. 40-41.) Petitioner appeals from these decisions of the Tax Court.

STATUTES INVOLVED

Title XI, § 1, § 47-1583, D.C. Code, 1961:

"The basis for determining the gain or loss from the sale, exchange, or other disposition of property shall be the cost of such property * * *."

Annotated Code of Maryland, 1957:

Art. 81, § 280:

" 'Gross income' means income from whatever source derived, including salaries, wages or compensation for personal services of whatever kind and in whatever form paid; alimony received, interest, dividends, rents, royalties and annuity income; and gains, profits and income derived from professions, vocations, trades, business and commerce. * * *."

Art. 81, § 279(j):

" 'Dividend' means any distribution made by a corporation (domestic or foreign) out of its net profits, whenever earned, to its stockholders or members, whether such distribution be made in cash or other property, except stock of the same class in the corporation. Amounts paid in liquidation or dissolution of a corporation shall be treated as dividends to the extent that they represent earnings of the corporation."

Federal Revenue Act of 1913, 38 Stat. 114, 167:

" § II(B). That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also

> from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent: * * *."

Federal Revenue Act of 1921, 42 Stat. 227, 239-240:

> "§ 214. (a) That in computing net income there shall be allowed as deductions:
>
> * * *
>
> (5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; ***."

SUMMARY OF ARGUMENT

The District of Columbia Income and Franchise Tax Act of 1947 provides that gross income shall include "income derived from * * * dividends", and dividends are in turn defined by that Act to include "earnings, profits, or surplus * * * earned by the corporation". It is now settled that distribution to a stockholder of earned surplus upon corporate liquidation constitutes a dividend within the meaning of the Act. When petitioner received the entire earned surplus of Lombardy, Inc. upon its dissolution, he received a dividend within the plain meaning of the statute, which was includible for tax purposes in his gross income. The fact that his financial position was the same both before and after the receipt of the earned surplus of Lombardy, Inc. in no way alters the

existence of petitioner's income derived as a dividend. The Supreme Court has considered the contention that "gain" is a necessary concomitant of "income", and has specifically rejected that contention on numerous occasions.

Petitioner contends that he incurred a deductible loss from his gross income as a result of a transaction which began when he purchased stock in Lombardy, Inc. and ended when that corporation was dissolved, both events being confined to one calendar day, January 7, 1960. Since petitioner, upon dissolution of Lombardy, Inc. admittedly received all the assets of that corporation which, in dollar amount, equalled the price he paid for the stock in that company, he could suffer no loss from the transaction in question. But assuming, *arguendo,* that he did suffer a loss from the transaction, the District's taxing statute provides that a loss can be deducted from gross income only if the transaction which caused the loss was a "sale, exchange, or other disposition of property". Since this Court held, in *Berliner* v. *District of Columbia,* 103 U.S. App. D.C. 351, 258 F.2d 651, *cert. denied* 357 U.S. 937 (1958), that a receipt of a liquidating dividend upon corporate dissolution did not constitute a sale or exchange, petitioner is foreclosed from relying on the loss provisions of the statute.

Further assuming, *arguendo,* that petitioner's dividend was a "sale, exchange, or other disposition of property", the transaction in

question would still fail to satisfy the requirements of the loss provisions of the statute. Those provisions require that the transaction (out of which the loss assumedly arose) must have been "entered into for the production or collection of income". Since the record shows that the transaction in question was limited to one calendar day and petitioner entered that transaction for the "sole purpose" of acquiring land and a building, he has failed to comply with the specific requirements of the loss provisions and thus his claimed loss must be denied.

The proper basis for depreciating petitioner's property is his investment in that property. That investment would be, as the District of Columbia Tax Court has determined, the taxpayer's pro-rata share of the capital, paid-in surplus and earned surplus reflected on the books of the corporation at the time of dissolution and represented in the property.

ARGUMENT

I. UNDER THE DISTRICT OF COLUMBIA'S TAXING STATUTE, A STOCKHOLDER RECEIVING EARNED SURPLUS AS A RESULT OF A COMPLETE CORPORATE LIQUIDATION INCURS TAXABLE INCOME ON THE AMOUNT OF EARNED SURPLUS DISTRIBUTED TO HIM.

Upon the dissolution of Lombardy, Inc., on January 7, 1960, petitioner, the sole stockholder in the corporation, received earned surplus in the amount of $324,318.88. (J.A. 3.) Subsequently, the District Government determined that the earned surplus received by petitioner constituted net income from a liquidation dividend and, on

March 13, 1964, assessed him for the tax due on that income. (J.A. 5.) The taxes were paid under protest on March 16, 1964. (J.A. 5.)

Under § 47-1557, D.C. Code, 1961, "net income" consists of "the gross income of a taxpayer less the deductions allowed * * *". "Gross income" is defined under § 47-1557a(a), D.C. Code, 1961, as:

> " * * * gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, including salaries, wages, and compensation paid by the United States to its officers and employees to the extent the same is not exempt under this subchapter, or income derived from any trade or business or sales or dealings in property, whether real or personal, other than capital assets as defined in this subchapter, growing out of the ownership, or sale of, or interest in, such property; also from rent, royalties, interest, dividends, securities, or transactions of any trade or business carried on for gain or profit, or gains or profits, and income derived from any source whatever." (Emphasis supplied.)

Since gross income includes "income derived from * * * dividends", it is necessary to consider the definition of a "dividend". § 47-1551c (m), D.C. Code, 1961, defines a dividend as:

> " * * * any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits, or surplus (other than paid-in surplus), whenever earned by the corporation and whether made in cash or any other property * * * and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation ***."

This Court has interpreted the foregoing definition of a "dividend" to include amounts distributed by a corporation to stockholders in

complete liquidation of the corporation, which distributed amounts represent the earnings, profits, or surplus earned by the corporation. Berliner v. District of Columbia, 103 U.S.App.D.C. 351, 258 F.2d 651, cert. denied 357 U.S. 937 (1958); District of Columbia v. Oppenheimer, 112 U.S.App.D.C. 239, 301 F.2d 563 (1962).

In petitioner's brief filed in this Court as well as at the trial in the Tax Court, petitioner conceded that the amount of earned surplus received upon liquidation of Lombardy, Inc. constituted a dividend within the meaning of § 47-1551c(m), defining dividends. (Pet.'s Br. 17-18; Tr. 40.) However, petitioner contends that the dividend is not includible in his gross income. The thrust of his contention is that before a dividend is includible in gross income under § 47-1557a(a), the taxpayer must receive "income" from the dividend. However, petitioner in its brief restricts the meaning of "income" by stating that "the Supreme Court regards the terms 'income' and 'gain' as interchangeable". (Pet.'s Br. 19.) Since the District of Columbia Tax Court determined at trial that the fair market value of the assets received by petitioner upon liquidation of Lombardy, Inc. did not exceed the amount he paid for the corporation's total outstanding capital stock (J.A. 17), petitioner concludes that since he received no "gain" from the liquidation distribution, he therefore received no "income derived from * * * dividends" within the intendment of § 47-1557a(a). The question, thus posed, is whether the District's

taxing act requires a taxpayer to receive gain or profit from a liquidating dividend in order that receipt of such dividend will constitute "income derived from * * * dividends".

In Uline, et al. v. District of Columbia, D.C. Tax Court, Opin. No. 1018 (Sept. 30, 1963), CCH D.C. Tax Ct. Rep. ¶ 200-032, [1] the District of Columbia Tax Court, in rejecting an identical argument, stated at page 5 of its opinion:

> "In connection with the definition of 'gross income', it should be observed that there is some confusion in the minds of counsel for petitioner. They seem to think that a dividend is not taxable gross income unless it can be said to be a gain or profit. They would have the section [§ 47-1557a(a), D.C. Code, 1961] in so far as it relates to 'dividends' read that 'The words "gross income" include gains, profits, * * * from * * * dividends', whereas the correct reading is 'The words "gross income" includes * * * income from * * * dividends'. * * *" (Bracketed material supplied.)

Similarly, at the trial in the instant case, when this definitional question arose, the following colloquy ensued between the District Tax Court and Counsel for Petitioner: (Tr. 46)

> "MR. NORDLINGER: It [§ 47-1557a(a) defining gross income] says income and it can't be income from dividends unless it is more than you pay.
>
> "THE COURT: You are confusing income with profit, gross income; lots of time there is no profit at all. * * *" (Bracketed material supplied.)

1. Now pending on appeal to this Court, No. 18,256.

In deciding Berliner, this Court held that amounts which were distributed in complete liquidation of a corporation and which represented payment out of earned surplus were properly includible in the taxpayer's gross income as a dividend. Petitioner, however, now attempts to limit the Berliner case so that taxability is dependent upon the receipt by the taxpayer of "gain" from the transaction. While the taxpayer in Berliner actually received a gain, the District of Columbia contends that the result obtained in that case was not dependent on the existence of a gain.

Petitioner, on the other hand, contends that in deciding Berliner, this Court established the rule that the taxpayer's cost of his stock must be deducted from the liquidating dividend in arriving at the taxable income from the distribution. If petitioner's interpretation is correct, Berliner would then require that the taxpayer realize a gain before he could be taxed upon the liquidating dividend distributed to him out of corporate earned surplus since his cost of the stock would always be deducted before the amount of the taxable dividend could be determined. However, since the taxpayer in Berliner was an original investor, his cost of the stock was identical to the paid-in capital. Therefore, not only is petitioner's limiting interpretation of Berliner based on speculation, but, in light of the existing case law on this subject, both in the District and in Maryland, petitioner's attempted limitation of the Berliner decision must be rejected.

In speaking to this point, the District of Columbia Tax Court, "an expert and specialized agency for the resolution of controversies between the District of Columbia and its taxpayers",[2] expressed its unequivocal view in the trial of the instant case (Tr. 44), that this Court, in Berliner, intended the "original cost of the stock", or paid-in capital, rather than the taxpayer's cost, to be deducted from the liquidation distribution in arriving at the taxable dividend.

This question was first considered by the District of Columbia Tax Court in the case of Dinkin v. District of Columbia, 89 Wash. L. Rep. 1293, D.C. Tax Ct., Opin. No. 987 (July 7, 1961). There, the original stockholder, L. S. Jullien, acquired shares of stock in a corporation for $3,680.16. Later, Jullien sold the same shares to petitioner Dinkin for $9,421.00. Upon dissolution of the corporation, $30,090.00 was distributed to Dinkin who argued that his cost of $9,421.00 should constitute the basis of the stock in determining what amount should be deducted from the liquidating dividend to arrive at his gross income. The Tax Court rejected the argument, holding that the basis of the stock was the amount of paid-in capital paid by the original shareholder. A similar result was reached by the Tax Court in Uline, et al. v. District of Columbia,

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2. Verkouteren, et al. v. District of Columbia, ______ U. S. App. D. C. ______, ______ F. 2d ______, No. 18,530 et al., slip opinion, p. 6 (May 11, 1965).

D.C. Tax Court, Opin. No. 1018 (Sept. 30, 1963), CCH D. C. Tax Ct. Rep. ¶ 200-032.

While the amount received by the taxpayers in the cases last cited exceeded their cost of the stock and, thus, did not cause them to suffer a loss, it is significant that the District of Columbia Tax Court interpreted § 47-1557a(a), defining gross income, in such a manner that, in an appropriate case, a taxpayer would be required to include in gross income an amount which was received as a liquidation distribution out of earned surplus, although the taxpayer actually suffered financial loss. To illustrate: One share of stock is initially issued to A for $10.00 and A subsequently sells the stock to B for $20.00. While B is still holding the stock, the corporation is completely liquidated and a liquidation distribution out of earned surplus of $15.00 is received by B. Although B receives only $15.00 on an investment of $20.00, he would be required, under the result in Dinkin, to report as gross income the amount of the liquidation distribution ($15.00) less the paid-in capital of the stock ($10.00) or the amount of $5.00.

This very situation arose in Rafferty v. Comptroller of Treasury, 228 Md. 153, 178 A.2d 896 (1962). Three taxpayers had purchased stock in a corporation which was subsequently dissolved. The corporation had an original paid-in capital of $1.00 per share. The taxpayers had paid $29.00, $28.00, and $12.28 a share, respectively. The liquidation

distribution paid to the corporation's shareholders out of earned surplus was approximately $22.00 a share. Thus, of the three taxpayers, two received less from the liquidation distribution than they had invested in the stock but, nevertheless were required to include as part of their gross income for Maryland tax purposes the difference between the distribution of $22.00 per share and the $1.00 per share paid-in capital.

The 1957 Maryland Code provision defining gross income, Art. 81, § 280, provided, in pertinent part, that " 'Gross income' means income from * * * dividends * * *." Under the Maryland Code, Art. 81, § 279(j), a dividend was defined as:

> " * * * any distribution made by a corporation * * * out of its net profits, whenever earned, to its stockholders * * *. Amounts paid in liquidation or dissolution of a corporation shall be treated as dividends to the extent that they represent earnings of the corporation."

This definition is, in substance, identical with § 47-1551c(m), D.C. Code, 1961, relating to dividends. Petitioners argued in Rafferty, as does petitioner Snow in the instant case, that although the distribution constituted a dividend, it was not the kind of dividend which was includible in gross income since receipt of the dividends did not constitute gain. In rejecting this argument, the Maryland Court of Appeals upheld the assessment against petitioners and quoted with approval the following statements:

" 'There can be no doubt of the power of the legislature * * * to define that accumulated profits, when declared in way of [a] dividend in liquidation, shall be income when received by the stockholder. * * *' "[3]

Continuing, the Court quoted the following with approval: " * * * '[t]he price at which the shareholder purchased his stock is irrelevant * * *.' "[4]

In deciding the case in that manner the Court made it clear that under the prevailing statute a dividend distribution paid out of earned surplus constituted "income" and was therefore includible in gross income, not only where there was no gain to the taxpayer but equally where the taxpayer suffered a financial loss.

The Supreme Court, in United States v. Phellis, 257 U.S. 156 (1921), had occasion to consider the requirement of "income derived from * * * dividends" where the pertinent provisions of the applicable federal revenue statute was indistinguishable from the District's taxing statute and the taxpayer, like petitioner Snow, received no gain from the corporate distribution. There, a New Jersey corporation had undergone a reorganization pursuant to which most of its properties were transferred to a newly formed Delaware corporation in return for which stock and securities of the new corporation were issued to the old

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3. 178 A.2d 896, 900 (1962).

4. Ibid.

corporation. The new corporation's stock in turn was distributed to the shareholders of the New Jersey corporation, which had continued in existence. As a consequence, the entire value of the stock so distributed was taxed to the New Jersey corporation shareholders as a dividend under the Federal Revenue Act of 1913 although no financial gain accured to the taxpayers as a result of the distribution. § II B of that Act, 38 Stat. 114, 167, defined net income in the following manner:

> " * * * gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever ***." (Emphasis supplied.)

Thus, in that federal statute, as in § 47-1557a(a), D.C. Code, 1961, "income" is defined, in pertinent part, as "gains, profits, and income derived from * * * dividends".

The lower court decision in the Phellis case, 56 Ct. Cl. 157 (1921), held, as petitioner Snow would have this Court now hold, that since the taxpayer received no "gain" from the distribution, he was improperly taxed. The Court of Claims' opinion concluded with the following language:

"It seems incredible that Congress intended to tax as income a business transaction which admittedly produced no gain, no profit, and hence no income. ***"[5, 6]

On appeal to the Supreme Court, the taxpayer presented the following argument in his brief:

" * * * On the 30th day of September, 1915, a stockholder of the New Jersey Company, having one share, held a certificate which he could sell in the open market for $795.00 * * * [After the corporate reorganization] the three shares of stock [received by taxpayer upon reorganization of the New Jersey Company] were worth $795.00, exactly what his one share in the New Jersey Corporation was worth on September 30, and we submit that the Appellee [taxpayer] had no 'profit' by the transaction, that there had been no 'gain' derived from capital, and that no gain had accrued to him, and that under no proper construction of the real facts of this transaction can it be held that the Appellee has 'derived' income from this 'readjustment of the financial business of the company'."[7] (Bracketed material supplied.)

In rejecting this argument and concluding that the taxpayer's relative financial position immediately before and immediately after the dividend was not the proper test for determining whether "income" has been received upon receipt of a dividend, the Supreme Court stated:

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5. Footnote 5 omitted.

6. 56 Ct. Cl. at 176

7. Brief for appellee, pp. 18-19, United States v. Phellis, 257 U.S. 156 (1921).

"That a comparison of the market value of claimant's shares in the New Jersey corporation immediately before, with the aggregate market value of those shares plus the dividend shares immediately after the dividend showed no change in the aggregate—a fact relied upon by the Court of Claims as demonstrating that claimant neither gained nor lost pecuniarily in the transaction—seems to us a circumstance of no particular importance in the present inquiry. Assuming the market values were a precise reflex of intrinsic values, they would show merely that claimant acquired no increase in aggregate wealth through the mere effect of the reorganization and consequent dividend, not that the dividend did not constitute income. * * *"[8] (Emphasis supplied.)

The Court explained its position as follows:

"The possibility of occasional instances of apparent hardship in the incidence of the tax may be conceded. Where, as in this case, the dividend constitutes a distribution of profits accumulated during an extended period and bears a large proportion to the par value of the stock, if an investor happened to buy stock shortly before the dividend, paying a price enhanced by an estimate of the capital plus the surplus of the company, and after distribution of the surplus, with corresponding reduction in the intrinsic and market value of the shares, he were called upon to pay a tax upon the dividend received, it might look in this case like a tax upon his capital. But it is only apparently so. In buying at a price that reflected the accumulated profits, he of course acquired as a part of the valuable rights purchased the prospect of a dividend from the accumulations—bought 'dividend on,' as the phrase goes—and necessarily took subject to the burden of the income tax proper to be assessed against him by reason of the dividend if and when made. He simply stepped into the shoes, in this as in other respects, of the stockholder whose shares he acquired, and presumably the prospect of a dividend influenced the price paid, and

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8. 257 U.S. 156, 170 (1921).

was discounted by the prospect of an income tax to be paid thereon. In short, the question whether a dividend made out of company profits constitutes income of the stockholder is not affected by antecedent transfers of the stock from hand to hand." [9] (Emphasis supplied.)

The Supreme Court's rejection in Phellis of the "gain" theory of taxable income does not stand as an isolated decision. In a later case, Helvering v. Midland Insurance Co., 300 U. S. 216 (1937), the taxpayer contended, as does petitioner Snow in the instant case (Pet.'s Br. 19), that "(g)ain or profit is the essential idea of 'income'; and in determining what constitutes 'income', substance and fact rather than form are to be given controlling weight." In holding the taxpayer liable for the taxes assessed, the Supreme Court rejected the taxpayer's contention saying:

> " * * * Income may be realized upon a change in the nature of legal rights held, though the particular taxpayer has enjoyed no addition to his economic worth. * * * 'The income tax laws do not profess to embody perfect economic theory. They ignore some things that either a theorist or a businessman would take into account in determining the pecuniary condition of the taxpayer'." [cases omitted.] (Emphasis supplied.) [10]

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9. Id., 257 U. S. at 171-72.

10. 300 U. S. 216 at 225 (1937). For other cases holding that the existence of taxable income is not dependent on the taxpayer's gain or profit, see Rockefeller v. United States, 257 U. S. 176 (1921); Taft v. Bowers, 278 U. S. 470 (1929); and Burnet v. Sanford & Brooks Co., 282 U. S. 359 (1931).

Petitioner attempts to limit the significance of the Phellis case by citing to this Court other Supreme Court cases in which income was defined in terms of gain or profit. (Pet.'s Br. 19-20.) Not only was this same argument made to the Supreme Court in Phellis, but, significantly, that Court, in deciding the Phellis case, considered some of the very cases which petitioner Snow cites to show that there can be no "income without gain". One such case, Eisner v. Macomber, 252 U.S. 189 (1920), was strongly relied on by the Court of Claims in awarding judgment to Phellis.[11] The same case was argued to the Supreme Court in Phellis' brief[12] and carefully considered by the Supreme Court in its opinion.[13] While recognizing the principle enunciated in the Macomber case, the Supreme Court nonetheless determined that taxable income, under the controlling statute which was substantially identical to the District's statute defining gross income, could exist although the taxpayer received neither gain nor profit on the transaction in question.[14]

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11. Phellis v. United States. 56 Ct. Cl. 157, 174-76 (1921).

12. Brief for appellee, pp. 10, 12, 17, 26 and 29, United States v. Phellis, 257 U.S. 156 (1921).

13. United States v. Phellis, 257 U.S. 156, 168-69 (1921).

14. Southern Pacific Co. v. Lowe, 247 U.S. 330 (1918), is cited by petitioner Snow in his brief (Pet.'s Br. 19) for the proposition that there can be no taxable income without gain. Like the Macomber case, the Lowe case was also considered by the Supreme Court in Phellis (257 U.S. 156, 168 (1921)) without any obvious effect on the ultimate disposition of the case.

In a further attempt to weaken the controlling effect of Phellis on the issue of "income without gain", petitioner points to the fact that the taxable income in Phellis resulted from a distribution of earnings by a going concern whereas the distribution in the instant case resulted from a corporate liquidation. (Pet.'s Br. 22-25.) With that distinction made, petitioner proceeds to place strong emphasis on the Supreme Court's statement, at page 167 of the Phellis opinion, to the effect that the company which distributed earnings to taxpayer Phellis was not, at the time of the distribution, in the process of liquidation but rather, was a "going concern". (Pet.'s Br. 25.)

Although this observation by the Court was significant at the time the decision was written in 1921, it has no limiting effect on the application of the Phellis opinion to the issue of "income without gain" in the instant case. To better appreciate the Court's reason for making that statement it is necessary to consider the dividend-taxing provisions of the 1913 Federal Revenue Act, the controlling tax act in Phellis. A brief discussion of this subject is provided by the following note at 1 Mertens, Law of Federal Income Taxation, § 9.89, n. 12:

> "The Rev Act of 1913 made 'dividends' taxable as income but failed to define the term and in two cases arising under that Act the Supreme Court applied the distinction between a dividend proper and a liquidating dividend. In Lynch v. Turrish, 247 U.S. 221 (1918), it was held that the distribution in liquidation by a corporation of all its assets * * * was a return of capital and not taxable income, but in Lynch v. Hornby, 247 U.S. 339 (1918), the Court held that the distribution by a going corporation to its stockholders after March 1, 1913, of profits accumulated prior thereto was a dividend and taxable income. * * *" (Emphasis supplied.)

Since the result of the Turrish case was to forbid the taxing of a liquidating dividend under the Federal Revenue Act of 1913, and since that Act was controlling in the Phellis case, the Supreme Court was required to specifically find that the distribution to taxpayer Phellis was not a liquidating dividend before it could hold that the distribution was taxable. This problem, however, does not exist in the instant case for, as this Court recognized in Berliner,[15] the Federal Revenue Act of 1913 failed to define a "dividend", whereas § 47-1551c(m), D.C. Code, 1961, specifically provides that a corporate distribution out of earnings, profits, or surplus "whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation" shall be taxed as a dividend. Thus, the distinction which petitioner Snow attempts to make in this regard in no way detracts from the application of the Phellis holding to the instant case.

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15. 258 F.2d 651 at 653, n. 7.

II. TAXING A CORPORATE LIQUIDATION DIVIDEND RECEIVED BY A SHAREHOLDER WHO REALIZED NO GAIN OR PROFIT ON THE TRANSACTION IS NOT VIOLATIVE OF THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT TO THE CONSTITUTION.

In a final attempt to show that petitioner was improperly assessed by the District, reliance is placed on the due process clause of the Fifth Amendment of the Constitution. Petitioner's contentions appear to be twofold. First, it is argued that although "income had previously been realized by a corporate entity, Lombardy, Inc.", petitioner's relationship with that corporate entity was so ephemeral that there was lacking "a sufficient constitutional basis for taxing him on a distribution which returns to him no more than his cost". (Pet.'s Br. 22.)

The District of Columbia takes the position, as it did at the trial below (Tr. 33), that petitioner was involved in two separate transactions pursuant to the acquisition of the entire common stock of Lombardy, Inc. The first transaction involved the purchase of that stock from Arthur R. Guy for $1,029,170.88. (J.A. 28.) The second transaction involved the liquidation of Lombardy, Inc. and subsequent distribution of its assets to petitioner at a time when he was the sole owner of the stock of the corporation. Petitioner's position, that there was an insufficient constitutional basis for the tax, fails to recognize the reality of the situation. If the owner of the entire stock of Lombardy, Inc. lacks sufficient relationship with the company to incur the tax upon the distribution of the corporation's earned surplus, it is subject to serious question who, if anyone, would have a sufficient relationship.

Petitioner's second constitutional argument is based on the contention that since the petitioner himself received no "gain" from the transaction, it would be violative of the Due Process Clause for the tax in question to be sustained. More specifically, petitioner contends that his income cannot be determined by gain on the property or income of another, namely, Lombardy, Inc. (Pet.'s Br. 23.) In taking this position, petitioner has failed to recognize a well-established tax doctrine succinctly stated by the Supreme Court in Taft v. Bowers, 278 U.S. 470, 484 (1929):

> "There is nothing in the Constitution which lends support to the theory that gain actually resulting from the increased value of capital can be treated as taxable income in the hands of the recipient only so far as the increase occurred while he [the taxpayer] owned the property * * *." (Bracketed material and emphasis supplied.)

This same constitutional point was argued to the Maryland Court of Appeals in Rafferty v. Comptroller of Treasury, 228 Md. 153, 178 A.2d 896 (1962). In rejecting the taxpayer's argument, the Maryland Court relied on United States v. Phellis, 257 U.S. 156 (1921), when it stated:

> " * * * In affirming the imposition of the tax, the [Supreme] Court [in Phellis] in effect stated that the earnings and profits of a corporation retained that status upon distribution, and, as such, were subject to tax regardless of what the stockholder had invested in his shares. And in Taft v. Bowers, 278 U.S. 470 (1929), the Supreme Court reaffirmed the constitutionality of the requirement that a succeeding owner of stock was compelled to assume the place occupied by

> his predecessor for the purposes of taxation. Other income without gain transactions, in which an income tax was imposed, have likewise been affirmed. See Helvering v. Midland Mutual Life Ins. Co., 300 U.S. 216 (1937); Burnet v. Sanford & Brooks Co., 282 U.S. 359 (1931)."[16] (Bracketed material and emphasis supplied.)

This same contention has also been rejected by this Court in Berliner.[17]

While this "miracle of income without gain"[18] may work a hardship in some cases, as the Maryland Court of Appeals stated in Rafferty, supra:

> "* * * if there is an element of unfairness, as there may be, in transactions such as these, then the cure therefore must come from the legislature and not the courts."[19] (Emphasis supplied.)

Following the decision in the Rafferty case, the Maryland legislature amended the definition of "dividend" to provide that where a stockholder retains his stock for more than 12 months, his cost can now be deducted from a liquidation dividend in determining his taxable income.[20] Until

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16. 178 A.2d 896, 900-901 (1962). To the same effect, see Rockefeller v. United States, 257 U.S. 176 (1921).

17. Berliner v. District of Columbia, 103 U.S.App.D.C. 351, 355, 258 F.2d 651, 655, cert. denied, 357 U.S. 937 (1958).

18. Powell, Income from Corporate Dividends, 35 Harv.L.Rev. 363, 370 (1922).

19. 178 A.2d 896, 901 (1962).

20. Ann.Code of Maryland (1957), Art. 81, § 279(j) (1964 Cum.Supp.).

Congress amends the District of Columbia Income and Franchise Tax Act to provide for the type of result now available to a recipient of a liquidation dividend in Maryland, receipt of such a dividend by a District taxpayer, at least to the extent of earned surplus received, constitutes taxable income within the clear meaning of the relevant provisions of the District's taxing statutes. As the Supreme Court stated in Helvering v. Midland Insurance Co., 300 U.S. 216, 224 (1937):

> " * * *Where the legal effect of a transaction fits the plain letter of the statute, the tax is held payable, unless there is clearly revealed in the Act itself or in its history a definite intention to exclude such transactions from the operation of its applicable language. * * *"

And as the United States Court of Appeals for the District of Columbia Circuit recently had occasion to state:

> " * * * The plain meaning of the words is generally the most persuasive evidence of the intent of the legislature. The plain meaning doctrine must be given application, however hard or unexpected the particular effect, where unambiguous language calls for a logical and sensible result. [case omitted.] A contrary course constitutes judicial legislation. ***"[21] (Emphasis supplied.)

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21. District of Columbia National Bank, Washington v. District of Columbia, ____ U.S.App.D.C. ____, ____ F.2d ____, No. 18,999, slip opinion, p. 3 (July 12, 1965).

III. UNDER THE DISTRICT OF COLUMBIA'S TAXING STATUTE, RECEIPT OF A LIQUIDATING DIVIDEND UPON CORPORATE DISSOLUTION CANNOT GIVE RISE TO A LOSS DEDUCTION.

A. This Court, in Berliner, interpreted the applicable provisions of the District's taxing statute in a manner which precludes application of the loss provisions to a liquidating dividend received upon corporate dissolution.

Petitioner Snow contends that if the liquidation dividend received by him upon dissolution of Lombardy, Inc. is taxable as "income derived from * * * dividends", he is *ipso facto* entitled to a loss deduction under § 47-1557b(a)(4)(B), D.C. Code, 1961. (Pet.'s Br. 28-33.) Petitioner's theory is that since the fair market value of the assets received by him upon dissolution of Lombardy, Inc. was no greater than the amount of his capital investment in the company, any taxable dividend received upon dissolution must necessarily reduce his return of invested capital by an equal amount, resulting in a loss equal to the dividend. If this position is sustained, petitioner would incur no tax liability to the District of Columbia as a result of the liquidation dividend.

Petitioner recognizes that the transaction in question was entered into when he purchased stock and was closed when Lombardy, Inc. was dissolved. (Pet.'s Br. 33.) Since both events occurred on the same day, January 7, 1960, petitioner is faced with the problem of showing where a loss arose which can be attributed to the transaction which began and ended on that date. On dissolution of the corporation petitioner received all of the assets of Lombardy, Inc. which, in dollar amount, equalled the

purchase price he paid for the total outstanding shares of stock in Lombardy, Inc. If, as the District contends, a part of the distribution was subject to tax as a dividend, there still could be no "loss" to petitioner.

§ 47-1557b, defining permissible deductions from gross income, provides, in pertinent part, as follows:

> "(a) Deductions allowed.—The following deductions shall be allowed from gross income in computing net income:
>
> * * *
>
> "(4) Losses.—Losses sustained during the taxable year and not compensated for by insurance or otherwise —
>
> * * *
>
> "(B) if incurred in any transaction entered into for the production or collection of income subject to tax under this subchapter, or for the management, conservation, or maintenance of property held for the production of income subject to tax under this subchapter, though not connected with any trade or business ***."

However, before a loss can be taken under the foregoing statute, it is first necessary to determine the basis for such loss. § 47-1583, D.C. Code, 1961, contains the following provision for making such a determination:

> "The basis for determining the gain or loss from the sale, exchange, or other disposition of property shall be the cost of such property * * *."

Petitioner's reliance on the loss provision of the statute, § 47-1557b(a)(4)(B), thus requires that the transaction from which petitioner's liquidating dividend arose must constitute the type of transaction set out in § 47-1583, i.e., a "sale, exchange, or other disposition of property".

In Berliner v. District of Columbia, 103 U.S.App.D.C. 351, 258 F.2d 651, cert. denied 357 U.S. 937 (1958), this Court specifically determined that receipt by a District taxpayer of a liquidating dividend upon corporate dissolution did not constitute a sale or exchange of his stock.[22] Since petitioner Snow received his liquidating dividend in the same manner as the petitioner in Berliner, i.e., by corporate dissolution, petitioner Snow's receipt likewise could not result from a sale or exchange of his stock. Consequently, the requirement of § 47-1583, defining basis for loss, is not satisfied and petitioner's reliance on § 47-1557b(a)(4)(B) is misplaced, requiring denial of his loss deduction.

B. The District's taxing statute requires that a taxpayer's loss, to be deductible under § 47-1557b(a)(4)(B), must result from a transaction entered into for the production or collection of income.

Assuming, arguendo, that this Court finds that petitioner's dividend resulted from a transaction which constituted a "sale, exchange, or other disposition of property" under § 47-1583, defining basis for loss, compliance with the loss provision of the statute is still

22. 258 F.2d at 655.

required. Petitioner recognizes that a loss deduction under the District's statute (§ 47-1557b(a)(4)(B)) is dependent on a finding that the taxpayer entered the transaction "for the production or collection of income". (Pet.'s Br. 33.) Similarly, petitioner recognizes that the transaction in question was " 'entered into' when the petitioner purchased stock * * * and was closed by the distribution in liquidation". (Pet.'s Br. 33.) Inasmuch as these two identifiable events, relied on by petitioner to delimit the time span of the transaction, occurred on the same day, January 7, 1960 (J.A. 33), the crucial question becomes whether the transaction which began and ended on that day was "entered into for the production or collection of income".

Petitioner interprets § 47-1557b(a)(4)(B), *supra*, page 2[illegible], in a manner which would permit him to take the loss deduction even though he had no intention, at the time the transaction was entered into, to produce or collect income. Petitioner takes the position that although he did not enter the transaction for that purpose, he is not foreclosed from taking the loss. He apparently contends that since he in fact received income in contemplation of the law, this fact must relate back to the time when he entered the transaction and supply the necessary intent, i.e., the statutory requirement that the transaction be "entered into for the production or collection of income".

The District contends, to the contrary, that since § 47-1557b (a)(4)(B) states that the loss must be incurred in a transaction "entered into for the production or collection of income", the words "entered into" must be applied with preciseness. Those identical words were used in § 214(a)(5) of the Federal Revenue Act of 1921, 42 Stat. 227, 239-240. That section provided:

> "§ 214. (a) That in computing net income there shall be allowed as deductions:
>
> * * *
>
> "(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction <u>entered into</u> for profit, though not connected with the <u>the</u> trade or business * * *." (Emphasis supplied.)

Although that Act used the phrase "entered into for profit" rather than "entered into for the production or collection of income" as does the District statute, this in no way detracts from the usefullness of the judicial interpretation given the words "entered into" in the following cases:

In <u>Tindle</u> v. <u>Heiner</u>, 17 F.2d 522 (W.D. Pa. 1926), reversed on other grounds, 276 U.S. 582 (1928), the United States District Court, in disallowing a loss deduction taken under the above statute, quoted with approval the following:

> "* * * 'The deduction allowed is for losses sustained in any transaction "entered into" for profit. The intent to make a profit must have existed at the commencement of the enterprise, or the right to deduct losses incurred is not within the contemplation of the statute. * * *' "[23] (Emphasis supplied.)

In Henry J. Gordon, 12 B.T.A. 1191 (1928), where the same statutory language was relied on by the taxpayer, the United States Board of Tax Appeals, in permitting the loss deduction, stated the following:

> "A review of the cases bearing upon this question reveals to us that where a taxpayer acquires property with the intention of selling it at a profit * * * if the predominating factor in its selection was the prospect of future profits, he is entitled to any loss sustained upon the sale thereof. * * *"[24] (Emphasis supplied.)

From the foregoing cases, it is evident that the phrase "entered into" has been construed to refer to the intent of the taxpayer at the time he entered the transaction. Thus, petitioner Snow must have intended to produce or collect income from a transaction which began when he purchased the stock of Lombardy, Inc. and ended when that corporation was liquidated, a period confined to one calendar day, January 7, 1960. It therefore becomes of critical importance to determine petitioner

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23. 17 F.2d at 523.

24. 12 B.T.A. at 1194.

Snow's purpose in entering the one day transaction. The following statements answer this inquiry.

At trial, the following colloquy ensued between counsel for petitioner and the Tax Court: (J.A. 10, 11.)

> "THE COURT: * * * You want the whole contract, why he [petitioner Snow] entered the contract [for the purchase of the stock of Lombardy, Inc.]?
>
> "MR. NORDLINGER: Yes, Sir.
>
> "THE COURT: I can answer that myself. He wanted to buy the building.
>
> "MR. NORDLINGER: That is exactly what we are trying to prove.
>
> ***
>
> "THE COURT: What difference does it make as to his [petitioner Snow's] reasoning [in signing the contract]?
>
> "MR. NORDLINGER: There could be some difference, I take it, depending upon his <u>intention.</u>
>
> "THE COURT: The intention was to buy the stock and I suppose if he got the stock, he could finally take and buy the building. I think that is plain.
>
> "MR. NORDLINGER: Yes, sir, that is what I am trying to prove. If it is plain to your Honor he had the <u>intention of purchasing the land and building and not the stock</u> —
>
> "THE COURT: I think it irresistible. * * *" (Bracketed material and emphasis supplied.)

And further on, petitioner's counsel remarked to the Tax Court. (J.A. 12.)

> "MR. NORDLINGER: We asked the District of Columbia to stipulate that the sole purpose of petitioner in entering into the contract for the purchase of the shares of stock was for the purpose of acquiring the land and building. * * * I called the witness to prove that is what he intended to do." (Emphasis supplied.)

In addition to the statements bearing on petitioner's intention as quoted above, petitioner's brief (Pet.'s Br. 14) supplies the following insight into petitioner's intention in entering the transaction: " * * * the taxpayer bought stock solely in order to acquire assets by liquidation". (Emphasis supplied.)

The foregoing statements establish, beyond question, that petitioner's "sole purpose" in entering the one day transaction was to acquire the land and building owned by Lombardy, Inc. The record nowhere indicates an expectation on petitioner's part of producing or collecting income from the transaction. The fact that petitioner's "sole purpose" in entering the transaction on January 7, 1960, was to acquire land and a building necessarily forecloses the possibility that petitioner entered the transaction for any other purpose. Since petitioner's claimed loss must relate to the date of the transaction in question, January 7, 1960, and since that transaction was not entered into for the production or collection of income, there was no compliance with the requirement of § 47-1557b(a)(4)(B), D.C. Code, 1961, that the loss must be incurred in a transaction "entered into for the production or collection of income".

It is significant that of the several cases cited in petitioner's brief in support of a loss deduction (Pet.'s Br. 29), all are readily distinguishable from the instant case. In all those cases, as distinguished from the instant case, the taxpayers clearly entered their respective transactions for the "production or collection of income". A brief consideration of those cases will emphasize this fact.

In Haystone Securities Corporation, 19 B.T.A. 954 (1930), the taxpayer purchased stock in a corporation in early 1923 and within two months the corporation declared a cash dividend equivalent to its entire retained earnings plus its paid-in surplus. On the day the dividend was paid, March 1, 1923, the stockholders authorized the directors to liquidate the corporation and distribute the remaining assets to the shareholders.

In Eric A. Pearson, 16 B.T.A. 1405 (1929), the taxpayers were members of a partnership which purchased stock in a corporation. The day following the stock purchase, a cash liquidating dividend was declared and the corporation was dissolved. The testimony in that case specifically showed that the partnership's purpose in acquiring the corporate stock was to "make some money out of the deal and liquidate it at the same time".[25] (Emphasis supplied.)

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25. 16 B.T.A. at 1406.

Finally, in Hamilton Woolen Co., 21 B.T.A. 334 (1930), the case most strongly relied on by petitioner, the taxpayer purchased all the outstanding shares in Central Mills Company on November 12, 1923. Ten days later, the directors of Central Mills declared a cash dividend in the amount of $110,000.00, payable on that day to the taxpayer as sole stockholder. Later the same day, as a result of a stockholder's meeting, dissolution of Central Mills was voted and the remaining assets were distributed to taxpayer.

The taxpayers in the foregoing cases cited by petitioner entered into their respective transactions for the obvious purpose of producing or collecting income in the form of substantial cash dividends. However, the facts surrounding petitioner Snow's acquisition of stock in Lombardy, Inc. make it equally obvious that he entered the one day transaction, not for the purpose of producing or collecting income, but for the "sole purpose of * * * acquiring the land and building". (J.A. 12.) Having failed to satisfy the requirements of the District of Columbia's loss deduction provision, petitioner's claimed loss must be denied.

IV. THE PROPER BASIS FOR DEPRECIATION OF PROPERTY RECEIVED ON DISSOLUTION OF A CORPORATION IS THE TAXPAYER'S INVESTMENT IN THAT PROPERTY, i.e., THE PROPERTY'S ALLOCABLE SHARE OF THE CAPITAL, PAID-IN SURPLUS AND EARNED SURPLUS REFLECTED ON THE BOOKS OF THE CORPORATION PRIOR TO DISSOLUTION.

The issue presented in Docket No. 19233 concerns the depreciable basis of the building petitioner acquired upon dissolution of Lombardy, Inc. on January 7, 1960. At the time of dissolution, a journal entry was made on the books of petitioner Chester A. Snow Rents, reflecting an allocation of $803,219.50 to land and building from the total amount paid for assets acquired.[26] Of that amount $149,157.27 was apportioned to land and $654,062.23 to the building in the proportions which the July 1, 1959 D.C. tax assessment bore to the land and building.[27] Petitioner then used the allocated figure for building, $654,062.23, as the basis for depreciating the building. (J.A. 51.) The District subsequently determined that the proper basis for depreciating petitioner's building

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26. The District does not concede the correctness of this entry. (J.A. 51.) In arriving at the figure $803,219.50, petitioner added a commission of $25,000 and costs of settlement amounting to $3,219.50 to the $775,000 cost of land and building. (J.A. 28.) Assuming arguendo that the commission and settlement fees are properly attributable to the assets obtained on dissolution, petitioner has failed to prove that the entire $28,219.50 of commission and settlement fees was properly charged to land and building, to the total exclusion of all other assets. If, of course, only earned surplus and capital are to be taken into account, as the District contends, the commission and settlement costs are not relevant.

27. The District does not concede the correctness of this method of allocation. (J.A. 51.)

was the "net book value" of the building and improvements on the books of Lombardy, Inc. at the time of dissolution, i.e., $91,415.83. (J.A. 51.) This determination was based on the fact that petitioner, in acquiring the building went through two separate transactions. (Tr. 13.) The first involved purchase by petitioner of all the outstanding stock of Lombardy, Inc. from Arthur R. Guy. The second involved dissolution of the corporation at a time when petitioner was the sole stockholder. The District's theory was that when petitioner acquired the corporation's stock he was purchasing stock, not corporate assets and, therefore, the price petitioner paid for the stock would not, without further proof, constitute the depreciable basis of the apartment building. Thus, the District concluded that the proper basis for depreciating the building was the "net book value", or undepreciated value of the building as it appeared on the books of the corporation at the time of dissolution, i.e., $91,415.83, and not the amount paid for the stock, as petitioner contends. (Pet.'s Br. 34.)

On March 13, 1964, when the District assessed the deficiency in tax against petitioner, Oppenheimer v. District of Columbia, 92 Wash. L. Rep. 799, D.C. Tax Ct., Opin. No. 1029 (April 9, 1964),[28] hereinafter Oppenheimer No. 2, had not been decided. Whatever merit the District's "dual transaction" theory may have had, it now appears that the issue of depreciation basis, because of the factual similarity

28. Now pending on appeal to this Court, No. 18,639.

existing between the instant case and the Oppenheimer cases, is substantially controlled by the Tax Court's opinion in Oppenheimer No. 2. A brief comparison of the essential facts in the Oppenheimer and Snow cases follows:

1. Petitioner in both cases owned stock in a corporation engaged primarily in the business of owning and renting residential property (Oppenheimer v. District of Columbia, 89 Wash. L. Rep. 565, D.C. Tax Ct., Opin. No. 983 (April 3, 1961), hereinafter Oppenheimer No. 1; J.A. 45).

2. The corporation in both cases was completely liquidated. In Oppenheimer, the dissolution occurred on January 3, 1953; in Snow, on January 7, 1960 (Oppenheimer No. 1; J.A. 45).

3. Upon dissolution of the corporation in the respective cases, the principal assets were distributed to petitioners in kind, consisting of improved real estate. In Oppenheimer, the building and land received by petitioner were valued at approximately $840,000.00; in the instant case, the building and land received by petitioner were valued at $775,000.00 (Oppenheimer No. 1; J.A. 28).

4. In each case, the corporation conveyed the real estate to petitioner-stockholder by deed. (Tr. 38-39).

5. In each case, the petitioner received corporate earned surplus upon liquidation of the respective corporations. In Oppenheimer, the earned surplus received by petitioner amounted to approximately $135,000.00; in the instant case, it amounted to $324,318.88 (Oppenheimer No. 1; J.A. 8).

In Oppenheimer No. 1 the Tax Court held that the fair market value of corporate assets distributed in kind to a stockholder upon the complete dissolution of a corporation did not constitute a dividend, the dividend being limited to the amount of the corporate earned surplus received by the stockholder. This holding was subsequently affirmed by this Court in District of Columbia v. Oppenheimer, 112 U.S.App.D.C. 239, 301 F.2d 563 (1962). In Oppenheimer No. 2, the same stockholder attempted to use the fair market value of the real property received as the basis for depreciation, contending that the matter was exclusively controlled by § 47-1583e(b), D.C. Code, 1961, which section allowed the use of fair market value as the depreciable base when the property was received in an exchange. The District of Columbia Tax Court, in rejecting that contention, stated in its opinion:

> "Section 47-1583e is of no help in solving the question here presented, since the catalog of incidents of acquisition [purchase, exchange, inheritance or gift, and acquisition prior to Jan. 1, 1939] does not include the receipt of property by a stockholder of a corporation distributed upon its dissolution, where that property is not a dividend, because it represents unrealized appreciation thereof. It is a casus omissus * * *."[29] (Bracketed material and emphasis in original.)

The Tax Court went on to state that:

> "* * * there is no provision in the Code or in any regulation of the Commissioners which provides specifically for the method or basis for determining

29. See joint appendix to briefs filed in this Court in Oppenheimer v. District of Columbia, No. 18,639, p. 28-29.

> the allowance for depreciation of property distributed to a stockholder by a corporation upon its dissolution, but which was not a dividend nor taxable as such, because it represented unrealized appreciation thereof."[30]

Section 47-1557b(a)(7), D.C. Code, 1961, allows as a deduction from gross income in computing net income "A reasonable allowance for exhaustion, wear, and tear of property used in the trade or business, including a reasonable allowance for obsolescence * * *." Assuming that real property which has been received in kind on a corporate dissolution, and which is subsequently used in a trade or business, can be depreciated, even though a specific statutory provision governing proper basis for depreciation is lacking, the District contends that the District of Columbia Tax Court, in Oppenheimer No. 2, stated the correct general approach for determining the basis for depreciation. The Tax Court there held the depreciable basis of such an asset to be:

> " * * * the petitioner's capital investment or portion of the paid-in surplus * * * plus the value of the portion of real estate distributed to her by the corporation that represented or reflected its earned surplus * * * less any portion thereof, of which the petitioner disposed since the acquisition thereof, and plus any subsequent capital improvements or additions thereto."[31]

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30. Id. at p. 29.

31. Id. at p. 34.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the decisions of the District of Columbia Tax Court were correct and should be affirmed.

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REPLY BRIEF FOR APPELLANT

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19,232

CHESTER A. SNOW, *Appellant,*

v.

DISTRICT OF COLUMBIA, *Appellee.*

SEPT 1

No. 19,233

CHESTER A. SNOW, t/a
CHESTER A. SNOW RENTS, *Appellant,*

v.

DISTRICT OF COLUMBIA, *Appellee.*

Appeal From the Tax Court for the District of Columbia

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TABLE OF CONTENTS

TABLE OF CITATIONS

Cases:

Statutes:

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19,232

CHESTER A. SNOW, *Appellant,*

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CHESTER A. SNOW, t/a
CHESTER A. SNOW RENTS, *Appellant,*

v.

DISTRICT OF COLUMBIA, *Appellee.*

Appeal From the Tax Court for the District of Columbia

REPLY BRIEF FOR APPELLANT

INTRODUCTION

Respondent and petitioner are in complete agreement that petitioner's sole purpose in acquiring the stock of Lombardy, Inc. was to obtain its land and building by liquidating the corporation (Resp. Br. 33-34). Starting from that premise, however, the parties arrive at vastly

different conclusions. Respondent concludes that petitioner, having obtained from the entire transaction assets worth no more than the $1,029,170.88 he paid for them, nevertheless was in receipt of dividend income in the amount of $324,318.88. Petitioner, on the other hand, maintains that the transaction should be regarded in all respects as a purchase of real estate (and other assets), and that no taxable dividend income can result from such a purchase of assets, for which he parted with cash and notes equal to their full value. In addition, petitioner asserts that he is fairly and legally entitled to deduct depreciation on the basis of his own investment in the assets purchased, and not on some lesser figure derived from the experience of the former corporate owner.

In Part I (pp. 13-15) of petitioner's opening brief, petitioner has cited cogent federal tax authorities establishing that where (as respondent now admits) the purpose of a stock purchase is to obtain the corporate assets by liquidation, the tax statutes dealing with income derived from liquidation and with the basis of assets received in liquidation are not applicable. While there are differences in how the present federal and District laws treat liquidations, such differences are irrelevant in the face of the fact that this transaction was in truth a purchase of assets. "Where no policies appear to require otherwise, [this Court has] generally, if implicitly, assumed that Congress intended similar construction of both the local and federal tax statutes, thus recognizing the practical convenience gained by having similar tax rules." *District of Columbia v. ACF Industries, Inc.*, __U.S. App. D.C.__, __F.2d__ (August 12, 1965).

Significantly, respondent has elected not to answer Part I of petitioner's brief — because there is no answer to it.

While petitioner believes respondent's arguments concerning the effect of the liquidation and dividend provisions has no proper bearing on the case, we shall briefly discuss certain points raised in respondent's brief.

I.

Can There Be Income Without Gain?

Respondent contends that a final liquidating distribution, returning to the taxpayer no more value than the amount he had invested in the property, results in taxable income despite the absence of gain. The contention finds no support in the principal cases relied upon. As shown in petitioner's opening brief, this Court's decision in *Berliner v. District of Columbia*, 103 U.S. App. D. C. 351, 258 F.2d 651 (1958), *cert. denied*, 357 U.S. 937 (1958), rested emphatically on the fact (absent here) that the liquidating distributions "not only returned to [the taxpayers] their capital investments in full but also a substantial additional amount as gain or profit", and no more than that profit was subjected to tax (Pet. Br. 16-17). And the Supreme Court's decision in *United States v. Phellis*, 257 U.S. 156 (1921), is authority only for the proposition that the severance of profits from a going corporation is subject to dividend tax without regard to whether the stockholder has recovered his cost, there having been no closed transaction realizing gain or loss on the stock (Pet. Br. 24-25).[1]

The other authorities cited by respondent (Br. 19) for the proposition that there can be "income" where there is no gain are so unlike the present case as hardly to merit distinguishment:[2]

Helvering v. Midland Insurance Co., 300 U.S. 216 (1937), was a case in which a mortgagee bid in the mortgaged property for enough to cover

[1] Whatever reasons may have impelled the Court to emphasize the absence of a final liquidation (Resp. Br. 21-22), the fact remains that the Court confined its decision to a distribution by a going concern, and the case is authority for no other.

[2] We need not discuss *Rockefeller v. United States*, 257 U.S. 176 (1921), which is merely a cumulative citation, since the Court declared it to be "in all essentials indistinguishable" from *Phellis*.

principal and interest, and then satisfied its bid obligation by applying against it the amount of the debt and interest due. The taxpayer claimed that the property was worth less than the principal of the debt, and that it had realized no interest income. The Court simply held that the mortgagee was in the same position as any third party would be in if he had incurred an obligation for the amount bid and had satisfied that obligation in part by credit of interest owing to him.

Taft v. Bowers, 278 U.S. 470 (1929), held that Congress could properly require a donee to compute gain on the basis of his donor's cost. The Court (p. 482) stressed that "In truth the stock represented only a single investment of capital — that made by the donor. . . By requiring the recipient of the entire increase to pay a part into the public treasury, Congress deprived her of no right and subjected her to no hardship . . . When she sold the stock she actually got the original sum invested, plus the entire appreciation; and out of the latter only was she called on to pay the tax demanded." In sharp contrast, the present taxpayer made an investment of his own equal to the full value he received in final liquidation, and the tax has been imposed on the return of his capital investment.

Burnet v. Sanford & Brooks Co., 282 U.S. 359 (1931), stands merely for the proposition that Congress may require the computation of operating profits and losses on an annual basis, and that an excess of income over expenses in one year may be taxed even though there were greater expenses in an earlier year. The Court (p. 364) noted, with regard to such expenses, that "[t]hey were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income". Here, of course, everything occurred in one year, the stock investment has been "converted", and the cost thereof must be recovered tax-free from the proceeds.

The only authority which in any way supports respondent's position is one decided under a somewhat similar provision of Maryland tax law. *Rafferty v. Comptroller of Treasury*, 228 Md. 153, 178 A.2d 896 (1962), a decision which stands alone.[3] Although the court relied upon a number of decisions from other States, none of them (so far as can be ascertained from the opinions) involved a situation in which the taxpayer was denied a tax-free recovery of his investment out of the proceeds of final liquidation, as in *Rafferty* and the present case.

Petitioner has shown, at pages 25-27 of his opening brief, that the administrative construction of the federal Revenue Act of 1921, as embodied in the Treasury Regulations, was contrary to the position taken in *Rafferty* and in accord with petitioner's view that there can be no dividend income in complete liquidation unless cost is first recovered. In determining the intention of Congress in legislating for the District, less weight should be given to a judicial interpretation of a state law, first announced 15 years after the enactment of the District law, than to the contrary administrative construction of the federal tax law which was the model for the District provision. *Berliner v. District of Columbia, supra*, 103 U.S. App. D. C. at 354, 258 F.2d at 654. See also *District of Columbia v. Johnson & Wimsatt*, 82 U.S. App. D. C. 81, 83, 160 F.2d 913, 915 (1947); *United States Casualty Co. v. District of Columbia*, 71 U.S. App. D. C. 92, 98, 107 F.2d 652, 658 (1939). "There is no better key to a difficult problem of statutory construction than the law from which the challenged statute evolved." *United States v. Congress of Industrial Organizations*, 335 U.S. 106, 112 (1948). *Cf. Allen v. Grand Central Aircraft Co.*, 347 U.S. 535, 541 (1954); *Deming v. United States ex rel. Ward*, 59 U.S. App. D. C. 188, 190, 37 F.2d 818, 820 (1930).

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[3] The court acknowledged that its decision was in conflict with *Lynch v. State Board*, 228 Ia. 1000, 291 N.W. 161 (1940).

II.

If a Dividend Is Taxable in These Circumstances, Is Petitioner Entitled to an Offsetting Loss Deduction?

Petitioner argues in the alternative that, if this Court should hold that a part of the final liquidating distribution was taxable as a dividend, the same amount cannot also be a recovery of his capital investment, and hence he sustained a loss on the liquidation (Pet. Br. 28-33). Respondent does not refute the fact that such a loss was sustained, but argues that it is not deductible under the statute because (1) the loss was not sustained on a "sale, exchange, or other disposition of property" (Resp. Br. 28-29), and because (2) the loss did not result from a transaction entered into "for the production or collection of income" (Resp. Br. 29-36).

Respondent (Br. 28) asserts that "before a loss can be taken under [§ 47-1557b(a)(4)(B)], it is first necessary to determine the basis for such loss". And, since § 47-1583 provides expressly what the basis for determining loss from a "sale, exchange, or other disposition of property" shall be, respondent contends (Br. 29) that no loss is deductible on a transaction which does not constitute a "sale, exchange, or other disposition of property". Then, since this Court declared in *Berliner* (for an entirely different purpose)[4] that liquidation was not a "sale or exchange", respondent's syllogism moves inexorably to the conclusion that a loss on liquidation cannot be deducted because liquidation is not a sale or exchange. There are several flaws in respondent's syllogism, however.

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[4] The holding was that the gain could not be treated as capital gain from a "sale or exchange" in the face of the express provision of § 47-1551c(m) that the proceeds of liquidation were to be treated (in part) as a dividend. The historical background that led the Court to its conclusion all related to that issue.

First, it is quite clear from decisions under the comparable federal statute (from which the District law differs only in excluding losses on capital assets held for more than two years) that many losses are allowable in addition to those sustained on sales or exchanges. A worthless stock loss (if the stock is not a capital asset) is allowable although such worthlessness does not involve a "sale or exchange". *Echols v. Commissioner*, 61 F.2d 191 (8th Cir. 1932). A loss from the destruction of or injury to non-capital assets by fire, storm, shipwreck or other casualty is expressly allowed (D. C. Code, 1961, § 47-1557b(a)(4)(C)), although such a loss does not result from a sale or exchange. *Herder v. Helvering*, 70 U.S. App. D. C. 287, 294, 106 F.2d 153, 160 (1939), *cert. denied*, 308 U.S. 617 (1939); *Helvering v. William Flaccus Oak Leather Co.*, 313 U.S. 247, 249 (1941). Undoubtedly also, like its federal counterpart, § 47-1557b(a)(4) comprehends the allowance of losses from such transactions as business or income-connected judgments against the taxpayer,[5] or his failure to recover judgment on a claim for which he has a cost,[6] or his failure to acquire a business asset toward which he has incurred expenditures,[7] or his payment for release from a business guaranty,[8] as well as many other transactions not embraced in the basis provisions (D. C. Code, 1961, § 47-1583; I.R.C. §§ 1011 *et seq.*). The provisions dealing with basis do not purport to limit the types of "losses sustained" which are allowable under the broad language of § 47-1557b (a)(4) of the District law and § 165 of the Internal Revenue Code. The basis provision, as the Supreme Court said of its early federal counter-

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[5] *E.g.*, *Anderson v. Commissioner*, 81 F.2d 457 (10th Cir. 1936).

[6] *E.g.*, *Protzmann v. Commissioner*, 276 F.2d 684 (1st Cir. 1960).

[7] *E.g.*, *Champlain Coach Lines v. Commissioner*, 138 F.2d 904 (2d Cir. 1943).

[8] *E.g.*, *Commissioner v. Condit*, 333 F.2d 585 (10th Cir. 1964); *J. J. Shea*, 36 T.C. 577 (1961), *aff'd per curiam*, 327 F.2d 1002 (5th Cir. 1964).

part, "is not all inclusive", and the courts will supply a rule for measurement of the loss if the statute is silent. *Heiner v. Tindle*, 276 U.S. 582, 586 (1928). See also *Helvering v. Owens*, 305 U.S. 468, 471 (1939). Where taxpayer has himself made a cash investment, subsequent to enactment of the tax law, the logical basis to allow is his cost. *Cf. Connecticut Inv. Corp. v. Pearson*, 42 A.2d 685, 686-687 (D.C. Mun. Ct. App. 1945).

Second, even if § 47-1583 were thought to limit the categories of losses allowable under § 47-1557b(a)(4)(C), it must be observed that § 47-1583 provides for the basis for loss not only from a "sale or exchange" but also from an "other disposition of property". Respondent's citation of *Berliner* does not meet the issue of whether a liquidation may be an "other disposition" of the stock, and respondent offers no reason why it is not such. Congress plainly intended the phrase to have a broader meaning, since it designedly used "sale or exchange" in some provisions and "sale, exchange, or other disposition" elsewhere. See *Herbert's Estate v. Commissioner*, 139 F.2d 756, 758 (3d Cir. 1943); *Crocker v. Lucas*, 37 F.2d 275 (9th Cir. 1930). This Court has held that the charge-off of a worthless debt is a "disposition" of the debt, even though the note is not physically surrendered. *Ayer v. Blair*, 58 U.S. App. D. C. 175, 26 F.2d 547 (1928). *A fortiori*, in the liquidation of a corporation, there is a "disposition" of stock when the stock investment is surrendered and extinguished, in return for a consideration consisting of the corporate property.[9]

Respondent's further argument (Br. 30) that the loss is not allowable because the transaction began and ended on the same day, and hence could not have been "entered into for the production or collec-

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[9] As shown in petitioner's opening brief, pp. 29, 32-33, a loss was allowed to the stockholder even under those federal revenue acts which did not treat liquidation as a "sale or exchange".

tion of income", is equally faulty. As respondent acknowledges (Br. 33-34), petitioner's sole purpose in acquiring the stock of Lombardy, Inc. was to liquidate the corporation and acquire its assets. If petitioner's primary contention is sustained, that it realized no dividend or other income by taking such action, petitioner would readily concede that its purchase of the stock was not, in itself, a transaction entered into for the production of taxable income. But the loss deduction becomes material only if this Court first holds that the liquidation did produce dividend income. While the taxpayer, of course, did not expect to incur taxable income, he did intend to liquidate the corporation, and hence, as a matter of law, must be deemed to have intended the legal consequences which this Court may hold flowed from such liquidation. *Cf. Army Times Sales Co.*, 35 T.C. 688, 704 (1961).

The statute, like its federal counterpart (but with the limitation, here inapplicable, relating to assets held for more than two years), "discloses a general purpose to permit deductions of capital losses whenever the capital investment is used to produce taxable income". *Heiner v. Tindle, supra*, 276 U.S. at 585.[10] If it is held that the liquidation produced taxable income, then the transaction entered into with intent to liquidate was a transaction entered into for the production of taxable income.

Respondent's attempts (Br. 35-36) to distinguish the federal cases relied upon by petitioner (Pet. Br. 29-30, 32-33) only serve to point up their similarities to the present case. In each of the *Haystone, Pearson* and *Hamilton* cases,[11] the taxpayers bought stock and promptly

[10] Respondent (Br. 31-32) quotes the district court's decision in the *Tindle* case, stating that it was "reversed on other grounds" by the Supreme Court. Actually, the Supreme Court reversed on the very point to which respondent's quotation from the district court relates.

[11] *Haystone Securities Corp.*, 19 B.T.A. 954 (1930); *Eric A. Pearson*, 16 B.T.A. 1405 (1929); *Hamilton Woolen Co.*, 21 B.T.A. 334 (1930). See also *Commissioner v. Sansome*, 60 F.2d 931, 932 (2d Cir. 1932), which respondent ignores.

caused the corporations to declare and pay cash liquidating dividends, concurrently with the distribution of their other assets in kind. Under a federal law similar in all presently material respects to the District statute, the cash distributions were taxed as dividends although the combined cash and property received did not exceed the taxpayers' investments; and losses of equal amount on transactions "entered into for profit" were allowed because the recoveries in liquidation, less the amounts treated as dividends, did not return the taxpayers' cost. Identically in this case, the taxpayer purchased stock and immediately, pursuant to his original intention, withdrew cash and property, a part of which respondent contends is taxable as a dividend. Wherein lies the asserted difference?

The loss issue is reached only if the petitioner's admitted purpose, to acquire assets, is laid aside and the liquidation is held to cause imposition of a dividend tax. Respondent cannot both apply the liquidation statutes to impose tax on the transaction and at the same time contend that the purpose to liquidate was not a purpose to produce the "income" which is taxed.

CONCLUSION

Petitioner's argument in its opening brief has been in no way weakened or refuted by respondent's brief. We respectfully urge this Court to reverse the Tax Court and order a refund to petitioner of the taxes paid based on a recomputation to be made in the light of the principles presented.

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PETITION FOR REHEARING EN BANC

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 19,232

CHESTER A. SNOW,

Petitioner,

v.

DISTRICT OF COLUMBIA,

Respondent.

No. 19,233

CHESTER A. SNOW, t/a
CHESTER A. SNOW RENTS,

Petitioner,

v.

DISTRICT OF COLUMBIA,

Respondent.

ON PETITION FOR REVIEW OF DECISIONS OF THE
DISTRICT OF COLUMBIA TAX COURT

United States Court of Appeals
for the District of Columbia Circuit

FILED DEC 17 1965

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

CHESTER A. SNOW, Petitioner, v. DISTRICT OF COLUMBIA, Respondent.	)	No. 19,232
CHESTER A. SNOW, t/a CHESTER A. SNOW RENTS, Petitioner, v. DISTRICT OF COLUMBIA, Respondent.	)	No. 19,233

PETITION FOR REHEARING EN BANC

Pursuant to Rule 26 of the General Rules of this Court, the District of Columbia respectfully petitions the Court for a rehearing of the above-entitled case by the entire Court sitting en banc.

On November 22, 1965, Senior Circuit Judge E. Barrett Prettyman and Circuit Judge Edward A. Tamm[1] reversed a decision of the District of Columbia Tax Court which had (1) sustained a deficiency

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1. Although Circuit Judge Harold Leventhal participated at the argument of this case, he did not participate in its consideration or disposition.

assessment against petitioner, as an individual, for income taxes in the amount of $20,285.95 and (2) cancelled a deficiency assessment against petitioner, as an unincorporated business, for franchise taxes in the amount of $380.44.

These consolidated cases present questions of first impression in this jurisdiction. The Court's determination of the legality vel non of the District's deficiency assessment will have a controlling effect on all future cases arising from similar, but not uncommon, real estate transactions in the District. Because a decision of this case is of material importance to the administration of the District's tax laws, it is respectfully submitted that the Court ought to reconsider en banc the novel and difficult tax concepts relied upon by both parties in this proceeding.

On July 17, 1959, petitioner, in order to acquire an apartment building owned by Lombardy, Inc., entered into a contract with Arthur R. Guy to purchase the entire common stock of Lombardy, Inc. from Guy for $975,000.00 with a provision for an upward or downward price adjustment based on a formula encompassed in the agreement. (J.A. 19.)

On January 7, 1960, the agreement was consummated, petitioner purchased the outstanding shares of common stock held by Arthur R. Guy for $1,029,170.88, and became the sole stockholder of Lombardy, Inc.

(J.A. 28.) On the same day, the corporation was liquidated and petitioner received the assets of the corporation, including a deed for the apartment building. (J.A. 33.) The fair market value of the assets received by petitioner did not exceed the price petitioner paid Arthur R. Guy for the corporation's stock. (J.A. 17.) At the time of liquidation, the corporation's earned surplus account amounted to $324,318.88. (J.A. 8.) The capital stock of Lombardy, Inc. amounted to $156,585.00. (J.A. 16.)

No. 19,232 (Tax Court Docket No. 1934)

On March 13, 1964, a notice of assessment for a deficiency in income taxes for the year 1960 in the amount of $17,264.64, with interest thereon of $3,021.31, was served on petitioner Chester A. Snow by the District. (J.A. 5.) The assessment resulted from the determination by the District's assessing authority that the earned surplus received by petitioner upon the dissolution of Lombardy, Inc. ($324,318.88) constituted income to petitioner (J.A. 7.) On March 16, 1964, petitioner paid the tax and interest under protest. (J.A. 5.)

No. 19,233 (Tax Court Docket No. 1935)

The second notice of assessment served on petitioner Chester A. Snow, t/a Chester A. Snow Rents, was for a deficiency in income tax for the year 1960 in the amount of $323.78, with interest of $56.66. (J.A. 47.) This assessment resulted from the determination by the

District's assessing authority that the proper basis for depreciation on the apartment building acquired by petitioner upon liquidation of Lombardy, Inc., was $91,415.83, the net book value of the assets received in liquidation (J.A. 49), rather than the alleged "cost" ($654,062.23) which petitioner allocated to the apartment building from the total purchase price of the outstanding stock of the corporation. (J.A. 38.)

No. 19,232

The District of Columbia Income and Franchise Tax Act of 1947, § 47-1557a(a), D.C. Code, 1961, provides in part that gross income shall include "income derived from * * * dividends". A "dividend" is in turn defined by that Act, § 47-1551c(m), to include a

> "***distribution made by a corporation * * * to its stockholders * * * out of its earnings, profits, or surplus * * * whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation * * *."

This Court has interpreted the foregoing definition of a "dividend" to include amounts distributed by a corporation to stockholders in complete liquidation of the corporation, which distributed amounts represent the earnings, profits, or surplus earned by the corporation. Berliner v. District of Columbia, 103 U.S.App.D.C. 351, 258 F.2d 651, cert. denied 357 U.S. 937 (1958); District of Columbia v. Oppenheimer, 112 U.S. App.D.C. 239, 301 F.2d 563 (1962). Thus, when, upon its dissolution,

petitioner Snow received the entire earned surplus of Lombardy, Inc. ($324,318.38), he received, within the plain meaning of the statute, a dividend which was includible for tax purposes in his gross income.

That petitioner's financial position was the same both before and after the receipt of the earned surplus of Lombardy, Inc., in no way alters the fact that petitioner received dividend income. The Supreme Court has considered the contention that "gain" is a necessary concomitant of "income," and has, on numerous occasions, specifically rejected that contention. United States v. Phellis, 257 U.S. 156 (1921); Taft v. Bowers, 278 U.S. 470 (1929); Burnet v. Sanford & Brooks Co., 282 U.S. 359 (1931); and Helvering v. Midland Insurance Co., 300 U.S. 216 (1937).

The case of Rafferty v. Comptroller of Treasury, 228 Md. 153, 178 A.2d 896 (1962), directly supports the District's position. There, the Maryland Court of Appeals held that, under the relevant Maryland tax statutes, which are substantially identical to those in the District, a dividend distribution paid out of earned surplus constitutes "income" and was therefore includible in gross income, not only where there was no gain to the taxpayer but equally where he suffered a financial loss.

Petitioner contended before the division of the Court hearing this case, and the division held, that, although the liquidation dividend received by petitioner upon dissolution of Lombardy, Inc. was taxable as "income derived from * * * dividends", petitioner was entitled to a

loss deduction under § 47-1557b(a)(4)(B), D.C. Code, 1961. The division accepted petitioner's theory that, since the fair market value of the assets received by him upon dissolution of Lombardy, Inc. was no greater than the amount of his capital investment in the Company, any taxable dividend received upon dissolution must necessarily reduce his return of invested capital by an equal amount, resulting in a loss equal to a dividend.

The transaction in question was entered into when petitioner purchased stock, and was closed when Lombardy, Inc. was dissolved. (Pet.'s Br. 33.) Since both events occurred on the same day, January 7, 1960, petitioner is faced with the problem of showing where a loss arose which can be attributed to the transaction which began and ended on that date. On dissolution of the corporation, petitioner received all of the assets of Lombardy, Inc. which, in dollar amount, equalled the purchase price he paid for the total outstanding shares of stock in Lombardy, Inc. Although a part of the distribution was properly taxed as a dividend, there still could be no "loss" to petitioner.

Section 47-1557b, defining permissible deductions from gross income, provides, in pertinent part, as follows:

"(a) Deductions allowed.—The following deductions shall be allowed from gross income in computing net income:

* * *

"(4) Losses.—Losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * *

"(B) if incurred in any transaction entered into for the production or collection of income subject to tax under this subchapter, or for the management, conservation, or maintenance of property held for the production of income subject to tax under this subchapter, though not connected with any trade or business ***." (Emphasis supplied.)

Before a loss can be taken under the foregoing statute, it is first necessary to determine the basis therefor. Section 47-1583, D.C. Code, 1961, contains the following provision for making such a determination:

"The basis for determining the gain or loss from the sale, exchange, or other disposition of property shall be the cost of such property ***."

Petitioner's position thus requires that the transaction from which his liquidating dividend arose must constitute the type of transaction set out in § 47-1583, i.e., a "sale, exchange, or other disposition of property".

In Berliner v. District of Columbia, 103 U.S. App. D.C. 351, 258 F.2d 651, cert. denied 357 U.S. 937 (1958), the tax was levied on corporate liquidation dividends declared out of earned surplus, no

different than the distributions received by petitioner Snow in the instant case. In *Berliner*, the taxpayers argued that the transaction (liquidation dividend) should be treated as an "exchange" of their stock, the gain from which would have been excluded from their gross income under § 47-1557a (b)(11), D.C. Code, 1961. In rejecting that contention, this Court held that receipt of a liquidation dividend out of earned surplus was neither a "sale" nor "exchange" of the taxpayers' stock.[2] In so doing, the Court pointed out that if such a distribution was treated as a "sale" or "exchange", taxpayers who held their stock for more than two years would escape District tax entirely.[3] The Court distinguished the holding under the federal cases on the ground that the federal statutes did not exempt capital gains, but taxed them in a special way.[4]

The District relied on the holding in *Berliner* when it argued to the panel that, since a liquidating dividend out of earned surplus was held not to constitute a "sale" or "exchange" in that case, likewise, such a distribution could not, in this case, constitute a "sale" or "exchange" as basis of a loss under § 47-1583 of the Code. The panel, however, rejected the District's position on the ground that this Court's statements in *Berliner* were limited to liquidating dividends paid out of earnings.

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2. 258 F.2d 651, 654, 655.

3. 258 F.2d 651, 655, n. 13.

4. *Ibid.*

The language in Berliner appears to be clear beyond question. As this Court stated in Insurance Agents' International Union, AFL-CIO v. N.L.R.B., 104 U.S.App.D.C. 218, 260 F.2d 736 (1958), aff'd 361 U.S. 477 (1960):

> " * * * One panel of this court will not attempt to overrule a recent precedent set by another panel, even though one or more of its members may disagree with the ruling."

In addition, a loss deduction under the District's statute is dependent upon a finding that the taxpayer entered the transaction "for the production or collection of income". As noted above, the transaction in question was " 'entered into' when the petitioner purchased stock * * * and was closed by the distribution in liquidation." (Pet.'s Br. 33.) Inasmuch as these two identifiable events, relied on by petitioner to delimit the time span of the transaction, occurred on the same day, January 7, 1960 (J.A. 33), the crucial question is whether the transaction, which began and ended on that day, was "entered into for the production or collection of income".

In every case cited by petitioner in his brief in support of this "loss" theory, the taxpayers entered their respective transactions for the main or sole purpose of producing income in the form of substantial cash dividends. Eric A. Pearson, 16 B.T.A. 1405 (1929); Haystone Securities Corporation, 19 B.T.A. 954 (1930); and Hamilton Woolen Co., 21 B.T.A. 334 (1930). Inasmuch as the record in this case discloses

that the petitioner entered the one day transaction for the "sole purpose" of acquiring the corporation's land and building (J.A. 12), he necessarily failed to comply with the statute's requirement that the transaction be "entered for the production or collection of income".

In view of the foregoing, the division of the Court which decided this case, erroneously held that the taxpayer incurred an offsetting loss, thereby cancelling his entire tax obligation to the District.

No. 19,233

The proper basis for depreciating the property received by petitioner on dissolution of Lombardy, Inc. is the taxpayer's investment in that property. Because of the factual similarity existing between this case and Oppenheimer v. District of Columbia,[5] the holding in Oppenheimer should be applied to the facts herein. In Oppenheimer, the District of Columbia Tax Court stated the depreciable basis of an asset acquired by corporate liquidation to be:

> " * * * the petitioner's capital investment or portion of the paid-in surplus * * * plus the value of the portion of real estate distributed to her by the corporation that represented or reflected its earned surplus * * * less any portion thereof, of which the petitioner disposed since the acquisition thereof, and plus any subsequent capital improvements or additions thereto."

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5. 92 Wash. Law Rep. 799, D.C. Tax Court Opin. No. 1029 (April 9, 1964), now pending on appeal to this Court, No. 18,639.

The importance of the questions involved hereinabove justify a rehearing of this case before the entire Court sitting en banc.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I, Henry E. Wixon, Assistant Corporation Counsel for the District of Columbia, attorney for respondent in the above-entitled cases, hereby certify that the foregoing petition is presented in good faith and not for delay.

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